SBA'S ECONOMIC DEVELOPMENT PROGRAMS

HEARING

BEFORE THE

SUBCOMMITTEE ON URBAN AND RURAL
ECONOMIC DEVELOPMENT

OF THE

COMMITTEE ON SMALL BUSINESS
UNITED STATES SENATE

NINETY-SEVENTH CONGRESS

SECOND SESSION

ON

SBA'S ECONOMIC DEVELOPMENT PROGRAMS

SEPTEMBER 28, 1982

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HEARING DATE

September 28, 1982: Morning session 1

SBA'S ECONOMIC DEVELOPMENT PROGRAMS

TUESDAY, SEPTEMBER 28, 1982

U.S. SENATE,
COMMITTEE ON SMALL BUSINESS,
SUBCOMMITTEE ON URBAN AND
RURAL ECONOMIC DEVELOPMENT,
Washington, D.C.

The subcommittee met, pursuant to notice, at 9:43 a.m., in room 424, Russell Senate Office Building, Hon. Alfonse D'Amato (chairman of the subcommittee) presiding.

Present: Senators D'Amato and Huddleston.

Also present: Robert M. Wilson, counsel; Dorothy Olson, hearing clerk; Alan L. Chvotkin, chief counsel, minority; and Bruce Ray, assistant to Senator D'Amato.

Senator D'AMATO. The Senate Small Business Committee hearing on section 503 will come to order.

Our first witness will be the SBA Administrator, the Honorable James Sanders.

Before we hear from Mr. Sanders, I have a statement for the record.

STATEMENT OF HON. ALFONSE M. D'AMATO, A U.S. SENATOR FROM THE STATE OF NEW YORK

Senator D'AMATO. The fact that most of America's jobs are generated by small business is well known and often cited. The Small Business Administration's role in economic development, however, is a much too well kept secret and something that I know that Mr. Sanders and others are attempting to spread the word on, particularly in this time of difficult economic projections.

Sections 501, 502, and 503 of the Small Business Act are designed to make the SBA an active partner with State and local governments and the private sector in making long-term capital available for small business expansion and job creation. Today's hearing will focus on the 503 program, a program which I believe will play an important role in helping to revitalize local communities across the Nation.

Section 503 is the newest and most active of SBA's economic development programs. Enacted in July 1980, section 503 is designed to encourage banks to make long-term loans available to small businesses under favorable terms. Without Federal guarantee programs such as 503, banks are frequently reluctant to make such loans to small companies.

Under section 503, SBA is authorized to guarantee the debentures issued by certified development companies, known as CDC's, to finance the purchase of land, plant, and equipment for small business expansion. SBA can guarantee up to 40 percent of the project costs, 10 percent comes from the company itself, and the remaining 50 percent comes from a third party, private sector lender, usually a bank. Maturities on these guaranteed loans can be up to 25 years.

SBA began certifying CDC's in late 1980. There are now 240 CDC's, with 47 more applicants pending. Recently, SBA has revised its criteria making it easier for statewide CDC's to be established.

While funding for other Federal economic development programs has been cut, the appropriation for 503 has been maintained at the $250 million level. Thus far in fiscal 1982, though, only $70 million of debentures have been sold to finance 362 projects. Even this limited expenditure, however, has resulted in the creation or retention of 19,000 jobs.

Clearly, much of the appropriation for this important program will go unused. Questions I hope to address today are why and what can be done to insure that the full amount of congressional approved funding is used.

Part of the problem is that 503 is new. Many CDC's are just getting off the ground and have yet to finance their first project. Much of the problem, however, lies with the regulations and SOP's adopted by the SBA. For example, a 503 loan cannot be made if a business is owned by different people than those who own the land on which it sits, even if the owners of both are members of the same family. An arbitrary 15-percent limit is imposed on the amount of expansion space which can be financed with a 503 loan. A third problem is the strictness with which SBA interprets the requirement that 503-financed buildings be multi- rather than single-purpose structures.

It is my hope that these problems and others can be worked out so that 503 can be more widely utilized. One problem which I feel must be resolved immediately, and which I intend to make a major focus of this hearing, however, is the fact that SBA, in complete and total contradiction of congressional intent, has refused to guarantee 503 loans for projects in which industrial development bond financing is used.

Since coming to the Senate, I have been a vocal supporter of IDB's. I think some in this room know that. Although I was not here when the conference report on Public Law 96-302 was adopted, I totally agree with what it said about section 503. Let me quote:

> SBA should not disapprove the guarantee of any debenture, or any loan made with the proceeds of a debenture issue, solely because the proceeds would be used in a project whose other sources of financing include, or are collateralized by, tax-exempt industrial revenue or development bonds.

This seems perfectly clear to me; yet SBA has refused to participate in any such projects. A 1965 OMB circular, A-70, which states that it is not Government policy to provide a Government guarantee of a tax-exempt issue has been cited as the reason for this intransigence. It would seem to me that a 1980 expression of the intent of Congress should clearly supersede this outdated bureaucratic memorandum.

But perhaps not. I have a copy here of OMB's response to SBA's fiscal 1982 budget request, dated November 20, 1981. I would like to read for the record the last item on the list which appears under the heading "Significant Policy Determinations."

"Continuation of the certified development company debentures program, provided that SBA develops procedures satisfactory to OMB and Treasury, that preclude indirect guarantee of tax-exempt securities."

In other words, Treasury and OMB established a policy of discrimination against industrial development bonds and then made it clear to SBA that if this policy was not enforced, there would be no funding for 503. Congressional support for IDB's and the clearly expressed congressional intent for 503 has been completely ignored.

Today we will receive testimony from Jim Sanders, the SBA Administrator, and Assistant Secretary of the Treasury Roger Mehle. I had hoped that Mr. Stockman would be here, but I received a phone call yesterday from his staff indicating that Mr. Stockman would not be able to be here. We will, however, have an additional hearing at which time we will invite Mr. Stockman to be here. He had indicated to us that he considered this to be of such importance that no one under Mr. Stockman would be able to be here. I find that a little difficult to believe and, if it is necessary, we will subpena Mr. Stockman, because I think that this committee, as any other congressional committee, when they give ample notice to those in the administration, should not be simply put on the shelf and told, Well, I'm too busy to be here. I think the Director could have had someone here.

We will also receive testimony from five individuals who have been intimately involved with 503 loan programs. The presidents of three local CDC's will testify, among them my friend Steve Gurian who heads the Long Island Certified Development Corp. A banker who has been involved in several 503 loans programs will testify.

We will hear from the most important person in this entire process, Jim D'Addario, a small businessman who has built his guitar string manufacturing business from 17 employees to nearly 250 over the past few years with a combination of SBA loans, most recently a 503 loan, and tax-exempt IDB financing through the New York State Job Development Authority.

Jim D'Addario—and I should be able to pronounce that better than most—Jim D'Addario's 503 loan is just 1 of the 13 so far made by the Long Island CDC. Nationwide, it was 1 of 362 made by March 31 of this year. These loans resulted in 13,096 jobs being created or retained, for an average SBA investment of $4,494 per job.

I think these figures make the case very clearly. The 503 program is a vital tool for economic development today. In addition to getting a status report, I hope we can begin the process of removing those obstacles which now impede 503 from doing what I believe it really could.

[The prepared statement of Senator D'Amato follows:]

STATEMENT OF HON. ALFONSE M. D'AMATO, A U.S. SENATOR FROM THE STATE OF NEW YORK

That most of America's now jobs are generated by small business is a well-known and oft-cited fact. The small business administration's role in economic development, however, is a much too well-kept secret. It is time to let the word out.

Sections 501, 502, and 503 of the Small Business Act are designed to make SBA an active partner with State and local governments and the private sector in making long-term capital available for small business expansion and job creation. Today's hearing will focus on the 503 program: A program which I believe will play an important role in revitalizing local communities across the Nation.

Section 503 is the newest and most active of SBA's economic development programs. Enacted in July 1980, section 503 is designed to encourage banks to make long-term loans available to small businesses under favorable terms. Without Federal guarantee programs such as 503, banks are frequently reluctant to make such loans to small companies.

Under section 503, SBA is authorized to guarantee the debentures issued by certified development companies [CDC's] to finance the purchase of land, plant, and equipment for small business expansion. SBA can guarantee up to 40 percent of the project costs, Ten percent comes from the company itself and the remaining 50 percent comes from a third-party, private sector lender, usually a bank. Maturities on these guaranteed loans can be up to 25 years.

SBA began certifying CDC's in late 1980. There are now 240 CDC's, with 47 more applications pending. Recently, SBA has revised its criteria making it easier for statewide CDC's to be established.

While funding for other Federal economic development programs has been cut, the appropriation for 503 has been maintained at $250 million. Thus far in fiscal 1982 only $70 million of debentures have been sold to finance 342 projects. Even this limited expenditure, however, has resulted in the creation or retention of 19,000 jobs. Clearly, much of the appropriation for this important program will go unused. Questions I hope to address today are "why" and "what can be done to ensure that the full amount of congressionally approved funding is used".

Part of the problem is that 503 is new. Many CDC's are just getting off the ground and have yet to finance their first project. Much of the problem, however, lies with the regulations and S.O.P. adopted by the SBA. For example, a 503 loan cannot be made if a business is owned by different people than those who own the land on which it sits, even if the owners of both are members of the same family. An arbitrary 15 percent limit is imposed on the amount of expansion space which can be financed with a 503 loan. A third problem is the strictness with which S.B.A. interprets the requirement that 503 financed buildings be "multi"-, rather than "single-purpose" structures.

It is my hope that these problems and others can be worked out so that 503 can be better and more widely utilized. One problem which I feel must be resolved immediately, and which I intend to make a major focus of this hearing, however, is the fact that SBA, in complete and total contradiction of congressional intent, has refused to guarantee 503 loans for projects in which industrial development bond financing is used.

Since coming to the Senate, I have been a vocal supporter of IDB's. Although I was not here when the conference report on Public Law 96-302 was adopted, I totally agree with what it says about section 503: "SBA should not disapprove the guarantee of any debenture, or any loan made with the proceeds of a debenture issue, soley because the proceeds would be used in a project whose other sources of financing include, or are collateralized by, tax-exempt industrial revenue or development bonds."

This seems perfectly clear to me, yet SBA has refused to participate in any such projects. A 1965 OMB Circular, No. A-70, which states that it is not Government policy to provide a Government guarantee of a tax-exempt issue has been cited as the reason for this intransigence. It would seem to me that a 1980 expression of the intent of Congress should clearly supercede this outdated bureaucratic memorandum.

But perhaps not. I have here a copy of OMB's response to SBA's fiscal 1982 budget request, dated November 20, 1981. I would like to read, for the record, the last item on the list which appears under the heading "significant policy determinations." "Continuation of the certified development company debentures program, provided that SBA develops procedures—satisfactory to OMB and Treasury—that preclude indirect guarantee of tax-exempt securities."

In other words, Treasury and OMB established a policy of discrimination against industrial development bonds and then made it clear to SBA that if this policy wasn't enforced, there would be no funding for 503. Congressional support for IDB's and the clearly expressed congressional intent for 503 has been completeiy ignored.

Today we will receive testimony from Jim Sanders, SBA Administrator, and Assistant Secretary of the Treasury Roger Mehle. I hope that they will be able to provide us with some compelling reasons why executive branch memoranda have superceded clearly expressed congressional intent over the subordination of tax-exempt bonds to 503 small business loans.

We will also receive testimony today from five individuals who have been intimately involved with 503 loans. The presidents of three local CDC's will testify, among them my friend Steve Gurian who heads the Long Island Certified Development Corp. A banker who has been involved in several 503 loans will testify and we will also hear from the most important person in this entire process, Jim D'Addario, a small businessman who has built his guitar string manufacturing business from 17 employees to nearly 250 employees over the past few years with a combination of SBA loans—most recently a 503 loan—and tax-exempt IDB financing through the New York State Job Development Authority.

Jim D'Addario's 503 loan is just one of 12 so far made by the Long Island Certified Development Corp. nationwide, it was one of 362 loans made by March 31 of this year which totaled $62.5 million. These loans resulted in 13,096 jobs being created or retained, for an average SBA investment of $4,494 per job.

I think these figures make the case very clearly, the 503 program is a vital tool for economic development. Today, in addition to getting a status report, I hope we can begin the process of removing those obstacles which now impede 503.

Senator D'Amato. At this point I would ask Jim Sanders, who had the opportunity to meet my dad, who works in the economic development program up on Long Island, to speak. To put it in your own words, Jim, he is much more senatorial than his son. You've got to watch him every time. We are delighted to have you with us.

STATEMENT OF HON. JAMES C. SANDERS, ADMINISTRATOR, SMALL BUSINESS ADMINISTRATION, ACCOMPANIED BY WAYNE FOREN, DIRECTOR, OFFICE OF LENDER RELATIONS AND CERTIFICATION, AND EDWIN T. HOLLOWAY, ASSOCIATE ADMINISTRATOR FOR FINANCE AND INVESTMENT, SBA

Mr. Sanders. Thank you, Senator.

It was a pleasure meeting your father. I don't recall saying he was more senatorial, though.

Senator D'Amato. No. He reminds me of that often, and he is also a better pinochle player.

Mr. Sanders. I could tell he would be a hard man to face down in a poker game.

Well, Mr. Chairman and members of this subcommittee, I appreciate the opportunity to be here, and if you will indulge me, I will try to abbreviate the written comments here by excerpting from them, if you wish.

Senator D'Amato. Let me say that your written remarks will be entered into the record as if read in their entirety.

Mr. Sanders. All right, thank you, Mr. Chairman.

If you will indulge me, then, I will just, I think, hit a few of the highlights, at least one or two that might be interesting to you in the thrust of your intent of this meeting.

I appreciate the opportunity to be here and discuss the SBA's 503 Certified Development Company program. I would like to briefly provide an overview of SBA's philosophy and approach to the program, assess its performance, and address pending legislative proposals that would affect the program, and, finally, discuss the promotion of the program.

The 503 program is one of the Government's principal economic development tools to assist communities, both urban and rural. It is intended to stimulate the growth and expansion of small businesses and to create jobs through a unique partnership between the Federal Government and certified development companies, which include State and local government and the private sector.

The role of the certified development company is to be a catalyst in economic development and to marshal the resources necessary to complete economic development projects, combining resources from both the public and private sectors. These projects are designed to create or retain a meaningful number of jobs in the communities affected, with a special emphasis on distressed areas.

As you pointed out, over 23,000 jobs have either been created or saved since the program's inception. The trend within SBA is to wholesale our programs and to rely to a greater extent on our private sector participants in delivering our services to the small business. This philosophy was incorporated into the 503 program, while at the same time establishing the necessary procedures and controls to assure proper oversight and evaluation of the CDC's.

In assessing the program, as you have indicated in your invitation to appear, the 503 program has the potential of being a very significant and worthwhile program and the kind of public-private partnership needed to spur economic development. We have given this program a high priority within overall credit limitation goals and the administration's philosophy on economic development.

I would like to share with you some of the highlights of the activity which have been generated by this program.

The first aspect of the program involves formation and certification of the development companies. We consider the certification of a development company to be an important event and the certificate a thing of value. Therefore, we have taken a cautious approach in this process. As of August 31, 1982, 267 applicants had been approved, and there were another 45 applications in the process at that date.

Once certified, it usually takes a CDC several months to get organized, identify eligible projects, and present to the SBA a debenture application to fund the 40 percent portion of the project. During the 23 months that the program has been operational, through August, there have been 583 debentures approved for a total of $101 million, $34.6 million of that in fiscal year 1981 and $66.7 million in fiscal year 1982. When the leverage of the private sector is considered, the total financing involves over $250 million, and, again, 23,000 jobs either being created or retained.

It has been the aim of this administration to properly implement and manage this program, refining its operation to insure adequate controls and the protection of the Government resources. Some Federal programs that began with fanfare and promises are either improperly designed or carelessly implemented. When allowed to grow unmanaged, the result is unnecessary cost to the taxpayers. We intend to learn from these earlier mistakes and to avoid these pitfalls. We are committed to seeing that this is a well-run and successful program.

While we would like to see some of the CDC's that have been approved for some time become more active, we are satisfied with the overall performance of the program thus far. One of the best examples of a CDC that has been an active and responsible participant is the Long Island Loçal Development Co., the president of which is a witness here today.

I would like to make a comment on Senate bill 1947, as passed by the House. There are two provisions in the pending legislation in the Senate that are a matter of concern. I am seriously concerned about section 18 of S. 1947 as passed by the House. This section would permit the proceeds of SBA financial assistance to development companies to be used for working capital. This is in addition to the currently permitted use of funds for land, capital improvements, and machinery. This would completely alter the concept of the 502 and 503 programs, which assist local communities in their economic development efforts through fixed-asset financing.

Working capital is obtained either from the private sector or with the assistance of other SBA programs. We see no justification for abandoning this concept.

Section 19 of the same bill would also affect the 503 program. Under the current law, development company debentures may be used to provide funding for up to 50 percent of the cost of the project. The proposal would permit financing for the senior lien position, private sector have to come from tax-exempt industrial revenue bonds, thus overturning current Federal policy.

The practical effect of this proposal would result in an SBA guarantee of the tax-exempt financing. For reasons well known to the committee, it is a longstanding executive branch policy to oppose such a double subsidy.

We do not oppose participation in projects where the source of financing other than the guaranteed debenture is from tax-exempt industrial revenue or development bonds. Rather, our opposition occurs when that financing is in a senior lien position to the SBA guaranteed debenture. We believe this position is not in violation of the statutory intent set forth in the conference report to Public Law 96-302.

We are prepared to clarify our regulations and procedures to allow participation so long as the SBA guaranteed debenture is in at least a parity position. This will allow small business to have access to tax-exempt financing and SBA guaranteed debentures for the same project.

You have asked that I comment on how the program can be effectively promoted. Accordingly, I would like to summarize some of the efforts that are being taken on our part and by others.

It is our view that the key to a successful program is competent, responsible, and capable community development companies which market the program in their area of operations. Accordingly, we are encouraging the formation of CDC's which meet this profile, and we have encouraged those that meet the requirements that were previously organized to apply to become CDC's. Our goal is adequate geographic coverage without oversaturation.

We also endeavor to support initiatives that will improve the CDC's capabilities and awareness of the program by public and private sector groups at all levels.

As I have indicated, we consider the issuing of a CDC's certification to be a significant event. Whenever possible, the SBA presents the certificate in a formal public ceremony. These have been well covered by the press, and this helps to inform the local small businessmen and the community at large about the existence and the purpose of their local CDC.

We have been working with various trade associations and interest groups on all levels to increase the awareness of the 503 program and to attract new CDC's capable of serving areas not adequately covered and to help improve the skill levels of CDC's and others that are involved in some way in the program.

Some examples are, first, the National Association of Development Companies, a trade association organized to represent CDC's; the National Association of Development Organizations, a trade association for regional planning commissions which serves rural areas, several of which have been approved to be CDC's; and the National Development Council, a private sector nonprofit organization active in economic development.

We have also met with representatives of groups such as Council of Mayors, Council of State Community Affairs Agencies, and Council of State Legislators to increase their awareness of the 503 program and its capabilities and benefits.

In the final analysis, SBA is the impetus for the creation of CDC's, and it is SBA that must insure that this program is promoted and implemented in a responsible manner. Delivery is in the field, and the program must be promoted primarily in the field. Our regional administrators and district directors give a high priority to this responsibility through activities such as the certification ceremonies, encouraging local and State participation through constant meetings and through other field efforts. Field managers rarely make a speech in which they do not discuss the 503 program.

Examples of local press coverage are included for your benefit as an attachment. I could show you many, many more. Local press coverage, I should say, has been excellent.

There are many private sector initiatives being undertaken to promote the program as well. For example, the Chemical Bank, the Central Fiscal Agent, is planning training sessions for bankers nationwide to increase their awareness of the program and to aid them in better understanding of the mechanics. The National Development Council has conducted training sessions for CDC personnel and others interested in the program. Their training involved marketing, loan packaging, processing, closing, and servicing.

Joint conferences between SBA field offices and CDC's take place constantly. A conference was held in Los Angeles where over 250 people attended. This included CDC personnel, bankers, local government representatives, and others who were interested in the program. A similar conference was held in Ohio.

Finally, our field offices have conducted training sessions for CDC's to increase their awareness of the policies and procedures of the program and create a close working relationship.

We are also working with other Federal agencies and departments to improve the cooperation and coordinate the delivery of programs. For example, we are working with the Department of

Housing and Urban Development. It is interesting to note that about 20 percent of our CDC's plan to use block grant and urban development action grant funds to provide the 10 percent CDC injection in some projects and also fund the CDC's overhead requirements. These were decisions made by local communities.

In conclusion, the SBA believes that the 503 program is a good example of implementing a Federal program in partnership with State and local governments and the private sector. I would also like to add that SBA is giving high priority to implementing this program in a responsible manner.

As we carry on the program, policy and procedural changes will be made from time to time to strengthen and improve it. As problems occur, appropriate and timely action will be taken to resolve them.

Mr. Chairman, this concludes my statement. I will be happy to answer any questions you may have.

[The prepared statement of Mr. Sanders follows:]

STATEMENT OF JAMES C. SANDERS, ADMINISTRATOR, SMALL BUSINESS ADMINISTRATION

Mr. Chairman and members of this subcommittee: I appreciate the opportunity to appear before you today to discuss the Small Business Administration's section 503 certified development company program. This program was created by Congress in July of 1980 by amending title V of the Small Business Investment Act of 1958.

I would like to briefly provide an overview of SBA's philosophy and approach to the program, assess its performance, address pending legislative proposals that would affect the program, and finally discuss the promotion of the program.

PHILOSOPHY AND APPROACH

The 503 program is one of the Government's principal economic development tools to assist communities, both urban and rural. It is intended to stimulate the growth and expansion of small businesses and to create jobs through a unique partnership between the Federal Government and certified development companies, which include state and local government and the private sector. SBA guarantees debentures of CDC's, which in turn use the proceeds to assist small business concerns by financing part of long-term fixed asset projects.

The debentures are sold to the Federal Financing Bank [FFB] for a term of 15 to 25 years. They bear a rate equal to the Federal Financing Bank rate, plus approximately 1 percent for servicing. Typically, the debentures provide permanent financing for 40 percent of the project cost, which is subordinated to a first mortgage of 50 percent of the project cost provided by a private sector lender. The CDC, or small business, provides the remaining 10 percent.

CERTIFIED DEVELOPMENT COMPANY

A CDC, by definition, is a statewide or local development company that has met specific qualifications and has demonstrated that it has the continuing capability to bring about economic development assistance within a defined geographical area. It must have representation from the following four groups: (1) local government, (2) private sector lending institutions, (3) community organizations and (4) business organizations.

The role of the CDC is to be a catalyst in economic development and to marshall the resources necessary to complete economic development projects, combining resources from both the public and private sectors. These projects are designed to create or retain a meaningful number of jobs in the communities affected, with a special emphasis on distressed areas.

Over 23,000 jobs have been either created or saved since the program's inception. The CDC's first responsibility is to market the program and identify feasible development projects. Typically, local government, lenders, and others, locate potential small business concerns that are in need of long-term fixed asset financing. Once a project is identified, the staff of the CDC helps the small business prepare its loan application and supporting financial exhibits. These are then submitted to the local SBA office. When SBA approves the loan, it gives the CDC an authorization identifying the terms and conditions required to sell the 503 debenture to the Federal Financing Bank. The CDC uses this authorization to secure private sector financing. In a typical project, a private sector loan is used for all of the construction financing and for 50 percent of the permanent financing. When the project is completed, the debenture is sold to the Federal Financing Bank. The proceeds are used to reimburse the interim lender. The CDC then proceeds with its servicing responsibilities for the small business.

The trend within SBA is to "wholesale" our programs and to rely to a greater extent on our private sector participants in delivering our services to small business. This philosophy was incorporated into the 503 program, while at the same time establishing necessary procedures and controls to assure proper oversight and evaluation of CDC's. "Wholesaling" is a significant departure from the philosophy under the 502 local development company program. However, it should be noted that the 502 program remains active.

OTHER SIGNIFICANT FEATURES OF THE PROGRAM

A significant program priority has been to develop the procedures and safeguards necessary to properly implement and manage the program and to provide broad utilization of federal resources. For example, while the statute provides for SBA guarantee of up to 50 percent of a project cost on a single project, typically our guarantee covers 40 percent or less. In practice, this means that on average for every $100,000 extended in long-term development capital to small business concerns, SBA incurs a contingent liability of $40,000 (Guaranteed debenture of CDC). This insures that within the program funding ceiling we can assist a greater number of small firms. Although there is no statutory ceiling, our regulations also provide that the SBA guarantee cannot exceed $500,000 to any one small business concern under the 503 program.

Another important control feature of the program is the use of a private sector Central Fiscal Agent [CFA] to perform disbursement, collection, investment and reporting functions. The CFA process provides the SBA, CDCs, and the small business concern with a number of important benefits:

(1) Effective control over the disbursement and collection of funds.

(2) Reports to CDC's and SBA on transactions and the status of portfolio.

(3) Invests the small business concern's escrowed monthly payments and, on a semi-annual basis, services the guaranteed debenture. The income from the investment of monthly payments is passed on to the small business when the debenture has been fully satisfied. In the event of default, the invested funds will be remitted to SBA to help offset losses on the debenture.

ASSESSMENT OF THE PROGRAM

As you have indicated in your invitation to appear, the 503 program has the potential of being a very significant and worthwhile program and the kind of public private partnership needed to spur economic development. We have given this program a high priority within overall credit limitation goals and the administration's philosophy on economic development.

I would like to share with you some highlights of the activity which has been generated by this program.

The first aspect of the program involves formation and certification of development companies. We consider the certification of a development company to be an important event and the certificate a thing of value. Therefore, we have taken a cautious approach in this process. As of August 31, 1982, 267 applicants had been approved. There were another 45 applications in process at that date.

Once certified, it usually takes a CDC several months to get organized, identify eligible projects, and present to SBA a debenture application to fund the 40 percent portion of a project. During the 23 months the program has been operational, (through August 31, 1982) there have been 583 debentures approved for a total of $101 million ($34.6 million in fiscal year 1981 and $66.7 million in fiscal year 1982). When the leverage of the private sector is considered, the total financing involves over $250 million and over 23,000 jobs being either created or retained (through August 31, 1982).

The third phase involves funding debentures. After projects are completed, the approved debentures are sold to the Federal Financing Bank. Of the 583 debentures approved, 277 projects have been completed and the debentures sold totaling $48.5 million.

It has been the aim of this administration to properly implement and manage this program, refining its operation to insure adequate controls and protection of Government resources. Some Federal programs that began with fanfare and promises are either improperly designed, or carelessly implemented. When allowed to grow unmanaged, the result is unnecessary cost to the taxpayers. We intend to learn from these earlier mistakes and avoid those pitfalls. We are committed to seeing that this is a well run and successful program.

While we would like to see some of the CDC's that have been approved for some time become more active, we are satisfied with the overall performance of the program thus far. One of the best examples of a CDC that has been an active and responsible participant is the Long Island local development company, the president of which is a witness here today.

COMMENTS ON S. 1947 AS PASSED BY THE HOUSE

There are two provisions in pending legislation in the Senate that are a matter of concern. I am seriously concerned about section 18 of S. 1947 as passed by the House. This section would permit the proceeds of SBA financial assistance to development companies to be used for working capital. This is in addition to the currently permitted use of funds for land, capital improvements and machinery. This would completely alter the concept of the 502 and 503 programs, which assist local communities in their economic development efforts through fixed asset financing. Working capital is obtained either from the private sector or with the assistance of other SBA programs. We see no justification for abandoning this concept. In addition, this proposal would probably have a negative effect upon the financial soundness of the program. With "bricks and mortar" as collateral, the program is on a sound financial footing; this could be weakened if funds were also used for working capital.

Section 19 of the same bill would also affect the 503 program. Under current law, development company debentures may be used to provide funding for up to 50 percent of the cost of a project. The proposal would permit financing for the senior lien position, private sector half to come from tax exempt industrial revenue bonds, thus overturning current Federal policy. The practical effect of this proposal would result in an SBA guarantee of the tax-exempt financing. In a typical transaction SBA is in a second lien position; the non-SBA portion has a first lien. In order to protect its second lien, SBA would be in effect guaranteeing repayment of a tax-exempt bond. For reasons well known to the committee, it is a long-standing executive branch policy to oppose such "double-subsidy."

We do not oppose participation in projects where the source of financing other than the guaranteed debenture is from tax-exempt industrial revenue or development bonds. Rather, our opposition occurs when that financing is in a senior lien position to the SBA guaranteed debenture. We believe this position is not in violation of the statutory intent set forth in the conference report to Public Law 96-302.

We are prepared to clarify our regulations and procedures to allow participation so long as the SBA guaranteed debenture is in at least a parity position. This will allow small business to have access to tax-exempt financing and SBA guaranteed debentures for the same project.

PROMOTION OF THE PROGRAM

You have asked that I comment on how the program can be effectively promoted. Accordingly, I would like to summarize some of the efforts that are being taken on our part and by others.

It is our view that the key to a successful program is competent, responsible, and capable CDC's which market the program in their area of operations. Accordingly, we are encouraging the formation of CDC's which meet this profile and we have encouraged those that meet the requirements that were previously organized to apply to become CDC's. Our goal is adequate geographic coverage without oversaturation. We also endeavor to support initiatives that will improve the CDC's capabilities and awareness of the program by public and private sector groups at all levels.

GENERAL PROMOTION

As I have indicated, we consider the issuing of a CDC's certification to be a significant event. Whenever possible, SBA presents the certificate in a formal public cermony. These have been well-covered by the press, and this helps to inform local small businessmen and the community-at-large about the existence and purpose of their local CDC.

We have been working with various trade associations and interest groups on all levels to increase awareness of the 503 program, to attract new CDC's capable of serving areas not adequately covered, and to help improve the skill levels of CDC's and others that are involved in some way with the program. Examples are as follows:

1. *National Association of Development Companies.*—A trade association organized to represent CDC's.
2. *National Association of Development Organizations.*—A trade association for Regional Planning Commissions, which serves rural areas, several of which have been approved to be CDC's.
3. *National Development Council.*—A private sector non-profit organization active in economic development.

We have also met with representatives of groups such as Council of Mayors, Council of State Community Affairs Agencies, and Council of State Legislators to increase their awareness of the 503 program and its capabilities and benefits.

In the final analysis, SBA is the impetus for the creation of CDC's, and it is SBA that must insure that this program is promoted and implemented in a responsible manner. Delivery is in the field and the program must be promoted primarily in the field. Our Regional Administrators and District Directors give a high priority to this responsibility through activities such as certification ceremonies, encouraging local and state participation through constant meetings, and through other field efforts. Field managers rarely make a speech in which they do not discuss the 503 program.

Examples of local press coverage are included as an attachment to my statement. I could show you many, many more. Local press coverage has been excellent.

INITIATIVE TO IMPROVE CDC'S SKILLS

There are many private sector initiatives being undertaken to promote the program as well. For example, Chemical Bank, the Central Fiscal Agent, is planning training sessions for bankers nationwide to increase their awareness of the program and to aid them in better understanding the mechanics of the program. The National Development Council [NDC] has conducted training sessions for CDC personnel and others interested in the program. Their training involved marketing, loan packaging, processing, closing, and servicing.

Joint conferences between SBA field offices and CDC's take place constantly. A conference was held in Los Angeles where over 250 people attended. This included CDC personnel, bankers, local government representatives and others who were interested in the program. A similar conference was held in Ohio.

Finally, our field offices have conducted training sessions for CDC's to increase their awareness of the policies and procedures of the program and create a close working relationship.

COORDINATION WITH OTHER FEDERAL AGENCIES

We are working with other Federal agencies and departments to improve cooperation and coordinate delivery of programs. For example, we are working with the Department of Housing and Urban Development. It is interesting to note that about 20 percent of our CDC's plan to use block grant and urban development action grant funds (HUD programs) to provide the 10 percent CDC injection in some projects and also help fund the CDC's overhead requirements. These were decisions made by the local communities.

CONCLUSION

SBA believes that the 503 program is a good example of implementing a Federal program in partnership with State and local governments and the private sector. I would also like to add that SBA is giving high priority to implementing this program in a responsible manner.

As we carry on the program, policy and procedural changes will be made from time to time to strengthen and improve it. As problems occur, appropriate and timely action will be taken to resolve them.

Mr. Chairman, this concludes my prepared statement. I shall be happy to answer any questions the subcommittee may have.

[From the Chicago Tribune, Feb. 23, 1982]

UNITED STATES AND PRIVATE SECTOR JOIN IN SMALL-BUSINESS LOANS

(By John McCarron)

The new brass plating tank at Ace Plating Co. on the Southwest Side may not be much to look at.

But the story of how it got there is an important one—important to the small business that bought it, and important to a city in need of jobs and industry.

"The new equipment tripled our capacity," said Michael Holowinski, who recently helped his father move the family business from cramped quarters on the Near West Side to a rehabilitated factory at 3433 W. 48th Pl.

"We've gone from 16 to 20 employees since the move," he said, "and, if the recession turns around, we'll go to 40."

The new equipment at Ace is among the first fruit borne by a business loan program set up here a year ago by local banks, community groups and the federal Small Business Administration (SBA).

At a time when federal aid to cities is being cut, the Ace loan may point towards the future of government aid.

The program joins modest federal loan-interest subsidies with heavy private investments.

The federal part of the package is the SBA "503" loan program. The local part is the Lenders Participation Plan, in which a group of 27 area banks and savings and loans have agreed to match private, unsubsidized loans with the 503s.

Here's how it worked for Ace Plating.

Holowinski and his father, Stanley, bought a rundown but roomy factory into which they could expand the business. But they still needed $110,000 worth of new equipment.

"Interest rates are so high that we had to find a way to get a low-cost loan, or else the numbers just wouldn't work," said Holowinski, a former state representative.

Their search led them to the Greater Southwest Development Corp., a business district development group operating out of a storefront at 6249 S. Western Ave.

Lynne Cunningham, loan specialist at Greater Southwest, roughed out the details of a 503 loan for Ace.

The Holowinskis got a 15-year, $49,000 loan from the SBA at 15 percent interest—4 percentage points lower than market rates. Pioneer Bank, one of the participating lenders, provided a $61,000 loan at an interest rate 1 percentage point above the prime, or about 20 percent.

The SBA loan money actually is raised by the Federal Financing Bank, which sells Treasury notes to the investing public.

Because Treasury notes pay less interest than commercial loans, the borrower gets an interest bargain on the government part of his loan.

Ace had to comply with some guidelines, however.

The loans must pay for equipment or physical improvements, and cannot be used to buy inventory or pay operating expenses. And the Holowinskis had to pay at least 10 percent of the cost of the equipment themselves.

Red tape?

"Sure, there was a wait," Holowinski said. "But Greater Southwest kept things moving. We submitted in March, won approval in April and got our money by November.

"The way interest rates are going, this is about the only way a business like ours can expand," he said. "I've recommended it (the 503 program) to a lot of firms we do business with."

A recently completed study of the 503 program here found that $9.4 million has been lent in the first year, and 768 new jobs created.

The study was done by Jeanne Pogge, a researcher for the Chicago Association of Neighborhood Development Organization, an umbrella group that provides technical assistance to 40 business groups throughout the city—groups like Greater Southwest.

Seven of the association's member organizations are certified to process 503 loans, said Laura Newman, executive director of the group.

"The expertise is getting stronger and stronger among the community groups," Newman said, adding that the application-to-payout time has been shortened to six months.

The association has forged a partnership with the city's Economic Development Commission, Newman said. Whenever a firm needs a loan too small to be funded through the commission's industrial revenue bond program, it is referred to the association.

The association then starts the company down the 503 path, where there is a $500,000 maximum on loans.

"When you have a recession and high interest rates at the same time," Newman said, "the ability to borrow at affordable rates becomes crucial for small firms. And small business is the bread and butter of Chicago's economy. That's where new jobs are to be had."

Company officials who want to learn more about the 503 program and Lender Participation Plan can call the association at 461-1015.

[From the York Daily Record, May 20, 1982]

ENTERPRISE FIRM GETS SBA BLESSING

(By Robert P. Ryan)

U.S. Sen. John Heinz was in York Wednesday to announce that York County's Small Enterprise Development Co. has been certified by the Small Business Administration—a move that will provide below-market interest rate financing to companies looking to get off the ground.

SEDCO becomes one of five SBA-certified development corporations in the state participating in the administration's 503 program, according to Peter Terpeluk, Jr., regional SBA administrator.

"This is the program that best defines what the Reagan administration is trying to do." Terpeluk said. "It gets the private and government sectors working together to form a company and make decisions locally."

Under the 503 program, the SBA will guarantee up to 40 percent or $500,000 of a loan to a fledgling company by issuing its own debentures.

The SBA can tap credit markets and pay below-market interest rates to investors, then offer the small business this part of the loan at cost, Terpeluk said. The SBA only guarantees the loan, he stressed; it does not make a loan.

The small business then has to finance 50 percent of its investment at market rates through a local bank and front 10 percent of the cost by itself. The SBA portion of the financing package is at fixed rates for 25 years.

"The SBA is not going to approve a loan where a small business gets in over its head." said Earl Herting, presidnt of both SEDCO and the York County Industrial Development Corp., and secretary of the county's Industrial Development Authority.

"That's why we have businessmen and bankers on the SEDCO board to advise (small businessmen) along the way," he said. "I think it's (the 503 program) going to make a difference.

"We have to find ways to finance capital expansions," Herting said. "This is one of the more promising ways."

Herting said 503 loans can be used to finance startup and construction costs, as well as some capital outlays for equipment. The effective rate on the total loan will be about 1.5 percentage points below bank rates, a factor that may spur small business investments.

"The beauty of the program is its leveraging" aspect, Terpeluk said. With the SBA guarantee of 40 percent or $500,000 of the loan, the limit to the deal a small business can work out becomes a function of how much leveraging banks will permit.

Loans secured under the 503 program must produce jobs, he said. One of the guidelines the SBA must follow when guaranteeing a 503 loan is that each $15,000 provided to a business must lead to the creation of one job. For example, a businessman seeking a $150,000 SBA guarantee must prove 10 jobs will be created by the new firm.

"We're looking for labor intensive programs," Terpeluk said. "The 503 program, right now, is our top priority" in revitalizing the state's economy by fostering the creation of new firms and new jobs, he said.

[From the Savannah Evening Press, April 10, 1982]

CITY CONSIDERING HELP FOR SMALL BUSINESSES

(By Rick Green)

The city of Savannah is considering establishing a corporation to provide long-term, low-interest financing for small businesses in Savannah.

City Manager A.A. Mendonsa has endorsed the proposal, which will be considered Thursday by the Savannah City Council during its regular meeting.

The agency to be called a certified profit corporation that could provide financing for 20 to 25 years for small businesses at interest rate of about 3 percent to 4 percent below the prime rate.

The CDC would be established under the Small Business Administration's 502/503 Development Corporation program.

"Financing mechanisms would be set up in cooperation with local lenders, utilizing SBA loan guarantees and debentures issued by the corporation," Mendonsa said in a memorandum to the mayor and alderman. "Loans are used principally for financing fixed assets, such as acquisition of land, equipment and building construction or renovation."

The cost to the city would be primarily in providing staff services to the corporation, Mendonsa said in his memo. The staff members, he said, will work part time on "loan packaging and technical assistance to small business."

Under the SBA program, the city also must pay 2.5 percent of the loan funds for the first two loans, Mendonsa said, but added that after the first two loans, no further contribution is necessary.

Although it is impossible to determine how much the first two loans will total, Mendonsa noted, he estimated the local cost would be about $15,000.

"It is expected that the primary emphasis of the program will be downtown," Mendonsa said. "However, the corporation's jurisdiction should extend citywide in the event there is some interest in other areas of the community."

Mendonsa listed the benefits as:

Helping retain existing downtown businesses and encouraging their expansion.

Attracting successful businesses now located elsewhere.

Expanding job opportunities for all income levels; businesses that should use the program include retailers, inns, small hotels, services, etc., many of which employ low and moderate-income individuals.

Since Congress is considering terminating or curtailing industrial revenue bonds, SBA may become the only alternative source of financing for commercial projects; also, (it) can provide financing for smaller business loans not appropriate for IRBs (industrial revenue bonds).

Mendonsa said the first step in establishing a CDC is appointing the minimum 25 members of the corporation, with at least two of the following groups represented on the board: local government, lending institutions, business organizations, community organizations.

The city manager noted that the Savannah Area Chamber of Commerce and local lending institutions have endorsed the program.

[From the Wisconsin Newspaper Association, July 24, 1982]

PLANNERS EYE DEVELOPMENT CORPORATION

(By Frank Church)

MENASH.—A small business development corporation, affiliated with the East Central Wisconsin Regional Planning Commission and backed by area financial institutions, will be up for approval at the commission's quarterly meeting Thursday in Wautoma.

It will be "filling a financing gap in the capital market for small businesses" in the Fox Valley, said David Less, of East Central.

If approved by the federal Small Business Administration, which will probably take several months to act on it, it will be able to make loans for business expansions and improvements.

The average size of the loans will be around $250,000, the agency estimates.

In a survey of banks, savings and loans, credit unions, local development corporations and chambers of commerce in the agency's 10-county region, over 80 percent said it would be a useful tool to spur business development in their communities.

Technically, the corporation will be set up under Section 503 of the Small Business Investment Act of 1958.

When it is certified by the SBA, it can process long-term, fixed-rate financing at below-prime rates.

Running things will be a 12-member board headed by George Indestad, President of Kimberly State Bank.

Representatives of 10 other banks and savings and loans will be either on the board of directors or among the corporation's 25 other members.

The corporation estimates that it will be able to line up eight loans in its first two years of operation.

Staff for the corporation will be furnished by East Central. Initial startup costs will be paid by the corporation members. Loans approved by SBA will include a grant to cover administrative costs, equal to 1.5 percent of the amount of the loan.

Less said one of the corporations first steps will be to get the word out that the loans are available.

He said he hopes the development corporation is only the first of many steps taken by East Central to actively push the economic development of the region.

The next step could be the development of a revolving loan program using federal Economic Development Admninistration funds, if those funds are approved by Congress.

The East Central agency board has been shifting its emphasis away from environmental concerns toward economic development programs as federal funding has been eliminated for many of the environmental efforts.

Less emphasized that the loans the corporation will process will be for "growing, profitable businesses" and not those just starting up, where there might be a substantial risk involved.

As set up, the corporation will have the authority to acquire, construct, convert or expand plants for sale or lease.

The Section 503 SBA loan debentures can cover up to 40 percent of the cost of plant expansions and improvements. Another 50 percent will have to come from private financial, while 10 percent must come from the small business or the development corporation itself.

In the case of the East Central corporation, the 10 percent can come from member companies.

Among the other board members are representatives of other financial institutions, industries, East Central members and municipal development officials.

[From the Miner County Pioneer-Howard, June 10, 1982]

SBA INTRODUCES ECONOMIC DEVELOPMENT PROGRAM FOR JOBS

A federal economic development program designed to help revitalize urban and rural communities has created or saved almost 14,000 jobs, at relatively low cost.

A survey by the U.S. Small Business Administation (SBA) showed that the Agency's Certified Development Company Program assisted 205 local development companies across the country in the last 21 months and that those companies in turn had helped 362 local small companies create or preserve 13,981 jobs through March 31.

"That job creation or job savings figure is undoubtedly higher today," said SBA Administrator James C. Sanders.

"But even the results so far show the program is becoming a major force in local economic development and revitalization and in job creation."

"Our program is in keeping with President Reagan's economic initiatives and with the directions I want SBA to stress—getting more participation and involvement by the private sector with Agency programs, especially in the area of jobs."

Sanders said the Certified Development Company Program—sometimes called SBA's 503 program, after a section of the Small Business Investment Act—is "an excellent deal for the American taxpayer. From October, 1980, through December, 1981, the investment cost per job created or saved averaged $4,981. In the first three months of 1982, when 101 program loans created or saved 3,797 jobs, the average investment per job averaged $4,277."

"These per-job investments," Sanders said, "are significantly lower similar costs of previous government job creation and job training programs. Government figures show that in 1980, for example, the cost of each worker placed in private employment through the Comprehensive Training and Employment Act (CETA) ranged between $17,000 and $22,000.

Apart from the minimal staff supervising the 503 program at the Agency, there are virtually no taxpayer costs involved in the SBA effort.

"I am particularly proud of the 503 program," Sanders said. "I view it as a major Administration economic development program that has benefitted hundreds of communities across the country."

Sanders also said that the 503 program "offers development companies financing and enables them to extend long-term financing to small business. This type of financing always is in relatively short supply for small firms."

Most of the development company assistance has been to small firms in wholesaling, retailing, and manufacturing.

Here is how the program works:

Any community can organize a development company. But the company must include a least 25 members and must include representatives from at least two of the following groups: a local government, a private lending institution, a community organization or a business organization.

Once the development company is certified by SBA, it can issue debentures to finance small businesses. Such debenture financing can be for up to 25 years. Funds can be used for land acquisition, building construction, expansion, renovation or equipment.

The certified development company puts up 10 percent of the small business financing. Typically, private lenders put up 50 percent the development company sells a debenture is guaranteed by SBA. The interest rate on the SBA guaranteed portion generally runs less than private market rates.

The amount of the debenture guaranteed by SBA may not exceed half the cost of the project.

In South Dakota, there are presently pending applications for certified status from three South Dakota Local Development Corporations. Awaiting certification are Northern Hills Community Development, Inc., Spearfish, South Dakota, serving the communities of Bell Fouche, Deadwood, Lead, Newell, Spearfish, Sturgis, Whitewood and the surrounding areas; Areawide Business Council Incorporated, serving the counties of Aurora, Bon Homme, Brule, Charles Mix, Davison, Douglas, Gregory, Hanson, Hutchinson, Jerauld, Sanborn and Yankton; and Aberdeen Development Corporation, Aberdeen, South Dakota.

Senator D'AMATO. Thank you very much.

My colleague, Senator Huddleston, has joined us. He has an opening statement to submit, and I want to yield to him for any first-round questions he might want to ask.

STATEMENT OF HON. WALTER D. HUDDLESTON, A U.S. SENATOR FROM THE STATE OF KENTUCKY

Senator HUDDLESTON. Well, thank you, Mr. Chairman.

I will submit for the record an opening statement.

[The prepared statement of Senator Huddleston follows:]

SENATE SMALL BUSINESS COMMITTEE
HEARING ON
SBA'S 503 CERTIFIED DEVELOPMENT COMPANY PROGRAM

STATEMENT BY
SENATOR WALTER D. HUDDLESTON
SEPTEMBER 28, 1982

MR. CHAIRMAN, TODAY WE BEGIN THE SENATE SMALL BUSINESS COMMITTEE'S FIRST FORMAL OVERSIGHT HEARINGS ON THE SMALL BUSINESS ADMINISTRATION'S SECTION 503 CERTIFIED DEVELOPMENT COMPANY PROGRAM. I HAVE BEEN A STRONG SUPPORTER OF THIS PROGRAM SINCE SENATORS NUNN AND WEICKER DEVELOPED IT WITHIN THIS COMMITTEE SEVERAL YEARS AGO AND WERE SO DILIGENT IN GETTING ITS ADOPTION IN 1980.

THE NEED FOR THIS KIND OF SMALL BUSINESS FINANCING PROGRAM IS GREATER TODAY THAN IT HAS EVER BEEN IN THE PAST. EVEN THOUGH INTEREST RATES HAVE COME DOWN A LITTLE, THEY ARE STILL EXCESSIVE AND BUSINESS BANKRUPTCIES ARE STILL OCCURRING IN RECORD NUMBERS. THIS MEANS THAT THE 503 PROGRAM CAN PLAY AN INCREASINGLY IMPORTANT ROLE BY PROVIDING THE DYNAMIC SMALL BUSINESS SECTOR WITH AFFORDABLE CAPITAL TO HELP LEAD US OUT OF THIS DEEPENING RECESSION.

HOWEVER, IF THE SMALL BUSINESS SECTOR IS TO ACHIEVE ITS FULL POTENTIAL, THE SMALL BUSINESS ADMINISTRATION WILL HAVE TO UTILIZE THE PROGRAM TO ITS MAXIMUM. THIS MEANS NOT ONLY USING THE PROGRAM TO ITS MONETARY LIMITS BUT ALSO EXERCISING RESTRAINT IN CREATING TECHNICAL OBSTACLES THAT REDUCE THE FLEXIBILITY OF THE PROGRAM. OUR GOAL SHOULD BE TO CLEAR THE PROGRAM'S PATH OF ALL ROADBLOCKS SO THAT SMALL BUSINESS GROWTH CAN ACCELERATE RAPIDLY WHEN ECONOMIC RECOVERY FINALLY BEGINS.

MR. CHAIRMAN, TO DATE MANY OF THE SUCCESSES OF THE PROGRAM HAVE BEEN IN THE URBAN CENTERS OF THE NATION. I APPLAUD THOSE EFFORTS, BECUASE IT IS NECESSARY TO PROVIDE THE OPPORTUNITIES FOR THOSE URBAN BUSINESSES TO GROW AND DEVELOP.

But the name of this subcommittee is, most appropriately, "urban AND rural" economic development, and I can tell you, Mr. Chairman, that the actual and potential benefits of this program in the rural parts of this nation are enormous.

My own state of Kentucky is a perfect example of how this program squares so perfectly with the needs of our rural areas. The Kentucky "503" company operates on a state-wide basis. One of the first 503 financings done by it was in Clay County, which has an unemployment rate of about 16%. The financial assistance made available to a tooling company there permitted it to add almost twenty NEW employees.

This type of financial assistance is being duplicated over and over again around the country. The number of certified development companies in rural areas in particular will be rapidly increasing, and I believe we should strongly support this program's continued availability to the nation's rural small business population.

Mr. Chairman, the program has been on the books since July, 1980, and there were some understandable delays in the beginning. I believe that most of those initial problems have been overcome. Nevertheless, there have been, and will continue to be, operational issues that must be addressed. I would hope, and I believe the Congress should expect, that the SBA and the development companies will work together to insure the success of this program.

We in the committee will try to provide stable, and adequate funding, as well as aggressive oversight, to insure that the certified development company programs meet our expectations, and assist in meeting the economic development needs of our country.

Senator HUDDLESTON. I express to you my commendation for conducting these hearings, which I think are timely here at the developmental period of this program.

I am pleased to see that we have among the witnesses Roger Peterman, who is president of the Commonwealth Development Finance Authority in Kentucky.

Do you want to begin questioning at this point?

Senator D'AMATO. Let me ask just one question. I have several others.

I think you have touched on this, Jim. We get to that old bugaboo about standard operating procedures of SBA disqualifying any application that comes in that would contemplate using industrial revenue bonds.

Now you say Well, we feel we can do that because if the industrial revenue bonds, in terms of paying back loan guarantees, seek a preference or priority, we use that as the reason for disqualifying that application.

Now, if you mean to tell me that what we have to do is add a qualification that, notwithstanding the use of industrial revenue bonds the SBA should make that loan available; that you shall be ordered to do this or that; that should not be a bar, what do you say then? Are you then going to follow our directions?

Mr. SANDERS. Well, if I understand your statement, as you know, I think——

Senator D'AMATO. My statement is basically that what we see here is an effort by OMB and by Treasury to thwart the will of the Congress. I just really do not understand. I went to school on the belief that there are three separate branches, and that when the Congress legislates, the President can veto, but barring that, legislation which becomes law ought to be followed. Is that your understanding, Senator Huddleston?

Senator HUDDLESTON. It always has been.

Senator D'AMATO. Now, unless somebody has changed the Constitution or the basic separation of powers, et cetera, that is what I have always been taught, and what I see here is just nitpicking.

I am not looking for a battle; I am looking for implementation. Lord knows, your job is tough enough. I do not heap blame on you; I commend you for operating with terrible restraints, with the problem of those who would make some cuts and really disavow your program on one side, unless you hew to their line; a Congress who says, My gosh, we want you to follow the law; and so there you are placed in the middle.

But what I am simply going to say is that I find that objectionable. I do not believe that you are following the will of the Congress.

Maybe Senator Huddleston has a question or an observation to make in relation to that.

Senator HUDDLESTON. Well, Senator, may I only inject this? Largely because of your leadership, there has been a significant move by the administration in this area to accept IDB's as an acceptable form of financing, so long as the SBA position in there is at least in parity. It only says that the SBA security must be in a senior position or at least parity.

Mr. SANDERS. Now, we are studying, as I said in the statement, regulations that will change and reflect that change by the administration. To be frank, we are not quite sure how you would achieve parity, but certainly we can go along with IDB's if ours is a senior security, and we feel that is in the interest of the Federal guarantees.

Senator D'AMATO. The problem is, as a practical matter, that no one is going to be using IDB's. They are just not going to get a bank who is going to take it if it is subordinate to all of the other creditors and obligations.

We have got some people over here, some bankers, and we could put them on and ask them if they would undertake that. I do not believe so. I think it is just another way of killing the program. I say killing it; it is precluding the use of IDB's.

Senator Huddleston?

Senator HUDDLESTON. I was just going to inquire whether or not the law in any way requires that particular interpretation of parity that you just indicated.

Mr. SANDERS. We are going to hear testimony from Treasury, and I would rather defer to their statement on that, if you don't mind.

Senator D'AMATO. I have no further questions.

Senator HUDDLESTON. I have no questions.

Senator D'AMATO. Again, let me commend you for undertaking a very difficult task and doing a commendable job, even in this new program. It does take time to get it moving and get it going forward. We anticipate even greater success, and if some people would let us use the IDB's, let you use them, with the only restriction being good, common business sense and judgment in terms of not pushing out loans without proper guidelines, I think you would see this program really expand. You would have used the $250 million that would have resulted in saving and creating a lot more jobs, and Lord knows we need it now. I don't know who, back in a certain place, does not understand what is taking place, that we need these jobs. It is a sad day.

Mr. SANDERS. Well, Senator, wherever I go I talk to this particular vehicle, the 503, as being the flagship of development for the agency. There is an enthusiastic response out there from the local communities, so I am very optimistic about its growth.

Senator D'AMATO. Thank you very much, Jim.

Mr. SANDERS. Thank you.

Senator D'AMATO. Mr. Roger Mehle, our Assistant Secretary of Domestic Finance, Department of the Treasury.

How are you this morning, Roger?

Mr. MEHLE. Good morning, Senator. I am fine, thank you.

Senator D'AMATO. We will accept your written statement in its entirety, and you can make any summaries you might want for any special points you want to make. Of course, you know what this committee is interested in. The nub of it is getting down to the IDB's.

Mr. MEHLE. Right.

Senator D'AMATO. We are interested in how we can break a stalemate that has existed for too long.

Mr. MEHLE. Right.

STATEMENT OF ROGER W. MEHLE, ASSISTANT SECRETARY OF DOMESTIC FINANCE, DEPARTMENT OF THE TREASURY

Mr. MEHLE. Thank you, Senator.

Mr. Chairman and Senator Huddleston, I do welcome the opportunity to discuss with you today the administration's Federal credit program policies as these policies relate to the use of tax-exempt obligations in conjunction with Federal credit assistance.

Providing Government guarantees, partial or entire, of tax-exempt obligations has long been recognized to be an inappropriate method of financing, for at least over the last 20 years. The rationale for this policy against Federal guarantees of tax-exempt obligations is as follows:

First, placing the credit of the United States behind a tax-exempt obligation creates a security that is superior to direct obligations issued by the U.S. Treasury and is contrary to the spirit of the Public Debt Act of 1941, which prohibits direct issuance by Federal agencies of obligations the interest on which is exempt from Federal income taxation.

Second, Federal guarantees of tax-exempts also have adverse effects on the municipal market because they create securities which are superior to all other tax-exempt securities issued by State and local entities. Consequently, such guarantees add to the pressures on the municipal bond market, crowd out other, less creditworthy municipal borrowers, and increase the borrowing costs of all municipal borrowers.

Finally, a guarantee of a tax-exempt obligation is an inefficient means of Federal financing because the revenue loss to the Treasury greatly exceeds the interest benefits to the borrower of tax exemption.

These arguments against the Federal guarantee of tax-exempt obligations apply regardless of whether the guarantee is direct or indirect. In the case of the SBA section 503 debentures, while the tax-exempt obligations would not be directly guaranteed by the Federal Government, they would be effectively secured by the subordination of SBA's interests to the interests of the holders of the tax-exempts. That is, subordination of the Federal Government's interest would give the tax-exempt securities preferred status in the event of a default. The holders of the tax-exempt obligations would be paid in full before there would be any payment on the subordinated obligations guaranteed by SBA. SBA would be taking all or virtually all of the credit risk, and the holders of the tax-exempt securities would thus be effectively guaranteed by the Government. As we have indicated, the Administration is strongly opposed to any such Federal guarantees of tax-exempt obligations and has acted to prevent them by adopting the current policy on subordination under the section 503 program and also by placing limitations on the pollution control bond guarantee program.

The Administration would not object, however—and I think this is, the essence of this discussion—to a combination of an SBA-guaranteed 503 debenture and tax-exempt securites as discussed in Administrator Sanders' statement, so long as the SBA guaranteed debenture is in at least a parity position, which is a relaxation of the approach.

That concludes my remarks, Mr. Chairman.

[The prepared statement of Mr. Mehle follows:]

FOR RELEASE ON DELIVERY
EXPECTED AT 9:30 a.m.
September 28, 1982

STATEMENT OF THE HONORABLE ROGER W. MEHLE ASSISTANT SECRETARY OF THE TREASURY (DOMESTIC FINANCE) BEFORE THE SUBCOMMITTEE ON URBAN AND RURAL ECONOMIC DEVELOPMENT OF THE SENATE SMALL BUSINESS COMMITTEE

Mr. Chairman and Members of the Committee:

I welcome this opportunity to discuss with you the Administration's Federal credit program policies as such policies relate to the use of tax-exempt obligations in conjunction with Federal credit assistance.

Providing Federal credit assistance in conjunction with tax-exempt obligations has long been recognized to be an inappropriate method of financing. This recognition dates back at least as far as the 1962 Report of President Kennedy's Committee on Federal Credit Programs and was reaffirmed in the Johnson Administration by the issuance of OMB Circular No. A-70 in 1965. Since 1970, Congress has enacted at least 24 statutes which preclude Federal guarantees of tax-exempts and in many cases authorize more efficient means of providing Federal credit assistance to the affected borrowers. As indicated in the list attached to my statement, these statutes affect virtually every sector of the economy -- agriculture, community facilities, education, energy, housing, rural business and economic development, and transportation.

In a March 23, 1981 message to Congress on the Military Construction Authorization Act of 1980, the President expressed his general opposition to Federally-guaranteed tax-exempt obligations. In the April 1981 "Additional Details on Budget Savings," the Administration specifically criticized the SBA pollution control bond guarantee program because it provides an indirect Federal guarantee of tax-exempt obligations and therefore, operates in violation of the Administration's credit policies. As you know, in his May 7, 1981 testimony before this Committee, SBA Administrator Cardenas opposed legislation increasing the authorization levels for the pollution control program in part because the program provides such Federal guarantees. Later in 1981, the Administration acted to limit the guarantees provided by this program to loans or contracts that are financed from the proceeds of taxable bonds.

The rationale for the Administration's policy against Federal guarantees of tax-exempt obligations is as follows:

--First, placing the credit of the United States behind a tax-exempt obligation creates a security that is superior to direct obligations issued by the U.S. Treasury and is contrary to the spirit of the Public Debt Act of 1941, which prohibits direct issuance by Federal agencies of obligations the interest on which is exempt from Federal income taxation.

--Second, Federal guarantees of tax-exempts also have adverse effects on the municipal market, because they create securities which are superior to all other tax-exempt securities issued by State and local entities. Consequently, such guarantees add to the pressures on the municipal bond market, crowd out other, less creditworthy municipal borrowers, and increase the borrowing costs of all municipal borrowers.

--Finally, a guarantee of a tax-exempt obligation is an inefficient means of Federal financing because the revenue loss to the Treasury greatly exceeds the interest benefits to the borrower of tax exemption.

These arguments against the Federal guarantee of tax-exempt obligations apply regardless of whether the Federal guarantee is direct or indirect. In the case of the SBA section 503 debentures, while the tax-exempt obligations would not be directly guaranteed by the Federal Government, they would be effectively secured by the subordination of the SBA's interests to the interests of the holders of the tax-exempts. That is, subordination of the Federal Government's interest would give the tax-exempt securities preferred status in the event of a default. The holders of the tax-exempt obligations would be paid in full before there would be any payment on the subordinated obligations guaranteed by SBA. SBA would be taking all or virtually all of the credit risk, and the holders of the tax-exempt securities would thus be effectively guaranteed by the Government. As we have indicated, the Administration is strongly opposed to any such Federal guarantees of tax-exempt obligations and has acted to prevent them by adopting the current policy on subordination under the section 503 program and also by placing limitations on the pollution control bond guarantee program.

The Administration would not object, however, to a combination of an SBA guaranteed 503 debenture and tax-exempt securities-- as discussed in Administrator Sanders' statement-- so long as the SBA guaranteed debenture is in at least a parity position.

Attachment

Statutes which preclude Federal guarantees of tax-exempt obligations

1. Loans for modernization and construction of hospitals and other medical facilities; P.L. 91-296, June 30, 1970, 42 U.S.C. 291j-7(e). 1/2/3/

2. New Community debentures; P.L. 91-609, December 31, 1970, 42 U.S.C. 4514. 2/3/

3. Water and waste facility loans sold out of the Agricultural Credit Insurance Fund; P.L. 91-617, December 31, 1970, 7 U.S.C. 1926(a)(1). 2/3/

4. Farm Credit Administration member institution guarantees; P.L. 92-181, December 10, 1971, 12 U.S.C. 2204.

5. Academic facilities loan insurance, P.L. 92-318, June 23, 1972, 20 U.S.C. 1132c-5.

6. Washington Metropolitan Area Transit Authority obligations; P.L. 92-349, July 13, 1972, D.C. Code 1-1441 note, 2/3/

7. Loans sold out of the Rural Development Insurance Fund; P.L. 92-419, August 30, 1972, 7 U.S.C. 1929a(h). 2/

8. Vocational rehabilitation facilities mortgages; P.L. 93-112, September 26, 1973, 29 U.S.C. 773(c).

9. National Railroad Passenger Corporation guaranteed obligations; P.L. 93-146, November 3, 1973, 45 U.S.C. 602(g).

10. Loan guarantees for initial operating costs of health maintenance organizations; P.L. 93-222, December 29, 1973, 42 U.S.C. 300e-(c)(3). 2/

11. Loan guarantees to assist the economic development of Indians and Indian organizations; P.L. 93-262, April 12, 1974, 25 U.S.C. 1451.

12. State housing finance and State development agency obligations; section 802 of P.L. 93-383, August 22, 1974, 42 U.S.C. 1440. 2/3/

13. Guarantees of obligations issued by coastal State and local governments to finance projects associated with the development of Outer Continental Shelf energy resources: section 7 of P.L. 94-370, July 26, 1976, 16 U.S.C. 1456a. 2/3/

14. Guarantees of Virgin Islands Bonds: P.L. 94-392, August 19, 1976, 48 U.S.C. 1574(a). 2/

15. Loan guarantee program for acquisition of property (urban renewal): section 108 of P.L. 93-383 as amended by P.L. 95-128, October 12, 1977, 42 U.S.C. 5308. 2/3/

16. Guarantees of obligations issued by State and local governments to finance essential community development and planning occasioned by Federally assisted alternative fuel demonstration facilities: section 19(k) of the Federal Nonnuclear Energy Research and Development Act of 1974, as added by section 207(b) of P.L. 95-238, Feb. 25, 1978, 42 U.S.C. 5919. 2/3/

17. Guarantees for startup and construction costs of municipal or industrial waste treatment and synthetic fuels demonstration facilities: section 19(y) of the Federal Nonnuclear Energy Research and Development Act of 1974, as added by P.L. 95-238, Feb. 25, 1978, 42 U.S.C. 5919. 2/3/

18. New York City loan guarantees: section 103 of the Internal Revenue Code of 1954, as amended by section 201 of P.L. 95-339, August 8, 1978, 26 U.S.C. 103. 2/

19. Loan guarantees of the National Consumer Cooperative Bank: section 108(c) of P.L. 95-351, August 20, 1978, 12 U.S.C. 3018.

20. Guarantees of combination financing for hospitals and guarantees of combination refinancing for multifamily housing projects: section 242 of the National Housing Act, as amended by section 315 of P.L. 96-153, December 21, 1979, 12 U.S.C. 1715z-7.

21. Loan guarantees to assist the Chrysler Corporation: section 11 of P.L. 96-185, January 7, 1980, 15 U.S.C. 1870.

22. Revenue bonds guaranteed or otherwise secured by the United States Synthetic Fuels Corporation; section 155 of P.L. 96-294, June 30, 1980, 42 U.S.C. 8755. 2/3/

23. Loan guarantees for municipal waste energy projects; section 233 of P.L. 96-294, June 30, 1980, 42 U.S.C. 8833. 2/3/

24. Guarantees of obligations issued to finance ocean thermal energy facilities; section 1110 of the Merchant Marine Act, 1936, as added by section 203 of P.L. 96-320, August 3, 1980, 46 U.S.C. 1279c. 2/

1/ Superseded by P.L. 93-641, January 4, 1975, 42 U.S.C. 300q.

2/ Statutes which authorize guarantees of taxable municipal obligations.

3/ Statutes which authorize interest subsidies on guaranteed taxable municipals.

Senator D'AMATO. Well, at least we got to parity.

Mr. MEHLE. Yes.

Senator D'AMATO. We got from nothing to parity, right?

Mr. MEHLE. Subordination to parity.

Senator D'AMATO. All right. Subordination to parity.

Mr. MEHLE. It is a step in the right direction. [Laughter.]

Senator D'AMATO. Gee whiz, I hope before my 6-year term is up, we might get it all the way.

But let me ask you, is, is this now an instrument that can be financed?

Mr. MEHLE. Yes, it is. I heard your earlier remarks and references to bankers who noted that subordinated tax-exempt obligations would be unattractive to investors and that as a matter of fact, they might be theoretically available and offered, but there would not be any takers.

Senator D'AMATO. You agree with that?

Mr. MEHLE. I do, yes. As a practical matter, I do.

Senator D'AMATO. Now, how would this parity work out? When SBA guarantees up to 40 percent, how would we work this out? Give me an example of how we would structure it.

Mr. MEHLE. Well, as an example, you would have a community development corporation, let's say, that was capitalized at, a million dollars. For the purposes of this discussion, lets say that $400,000 of the million was furnished by CDC guaranteed obligations, $500,000 was furnished by tax-exempt obligations, and the balance $100,000, was furnished by equity.

In case the CDC were to go into liquidation or bankruptcy, which is when the question of subordination and parity really comes to bear, the creditors of the CDC, both tax-exempt and Government-guaranteed, would stand in line together, rather than one being in front of the other. So they would each bear the same risks with respect to the liquidation of the assets of the CDC. That is the kind of risk that people do not mind taking as long as there is intelligent equity capitalization of the enterprise. In this case I suggested $100,000; that might be regarded as small, but nevertheless——

Senator D'AMATO. Well, half a loaf is better than no loaf, if we really get half a loaf.

Mr. MEHLE. Yes.

Senator D'AMATO. That is the question. I am not in a position to pass judgment and say, Look, this is something that, sounds like it is an improvement. I don't know whether or not banks will feel that this is something that they can do or whether CDC's feel that they will be able to utilize the IDB in this way. Certainly it appears to be something.

Senator Huddleston, do you have any observations?

Senator HUDDLESTON. Well, I think you hit the nub of the question, how does it work in practice. I think a reasonable case or reasonable position has been stated as far as the Government guaranteeing tax-exempt securities. I think certainly there is some logic to that.

It does bring up the question. As we have tried to direct certain economic activities toward a needed area, how far can we go in making sure that everything is equal? Sometimes it may be appropriate to be a little unequal or to try to meet specific problems that this committee has identified as existing out there.

On the other hand, I think it may well be worth exploring this suggestion that you have with the other people who are going to be appearing here to see how they feel about the practicality and the workability of it. That is really the bottom line.

Senator D'AMATO. Roger, you and I have had, I think, our differences, but basically, we have a good, solid working relationship and understanding, and I have found that you have always been somebody who has been open and kept your promises, which is not something we can say about a lot of people up here in this mirage. I was going to say menagerie.

But let me ask you, supposing we give this a shot. You know, it is always easy; the bankers are going to want more; they are not going to be happy. My good friend Don Gallagher is going to say, Oh, I don't think it is going to work, because, after all, he would rather be in a secure position. I understand that; we all understand that.

Mr. MEHLE. Sure.

Senator D'AMATO. But let's suppose, aside from conjecture and hypotheticals, we get out there in the field. Three months go by, 6 months go by, a fair opportunity to use this new parity, and it doesn't work out and there are no takers, and it is not because the propositions do not look to be sound and economical, although there are fly-by-night operations that do not have substantial equity and business background. But there are sound local businesses.

Are you willing, then, to come around? You know, we are talking about financing $250 million. We are not talking about the kind of situation that is going to drive the bond market up. I voted against the all-savers turkey that took $51 billion plus, all these wonderful things for home building, because I said, there is where you are going to, in effect, take monies away from municipalities and affect the instruments of the Federal Treasury and local governments and their financing. But $250 million nationwide annually is not going to do that.

Can I get from you a commitment? Are you in a position to give us a commitment?

Mr. MEHLE. I don't think that I can give you a commitment, but I can for a moment address the relevant considerations if it should not work, as you point out.

If it were not to work, that would mean that the proposed tax-exempt creditors thought that there was not enough equity in the project, that is, that they were not sufficiently protected because of the skimpiness of equity. What they would be saying in effect is that they want more equity, which is the same as wanting participation by some other subordinated creditor because that is equity to a senior creditor. So, they would be reviewing the project and saying, "No, this project has to have 10 percent of the ordinary and conventional kind of equity, which in our illustration amounted to $100,000, and $400,000 of CDC Government-guaranteed obligations, which are subordinated to our interests. Then we will be prepared to step in with the balance, an additional $500,000, but only under those terms will we do that."

I think in that instance it would be appropriate to review the degree of assistance that is actually being given to these undertakings and question why it is that so much equity is needed, for essentially what is being furnished in the illustration that I have given is 40 percent equity by the Federal Government rather than 40 percent debt from the viewpoint of the senior creditors. I think that those kinds of considerations would be relevant, if it turns out that it does not work.

Senator D'AMATO. Roger, what about the pollution control program? Are we talking about parity there, too?

Mr. MEHLE. The pollution control program has been changed, as I recall, to be a taxable program. That is a program which involves, in effect, a Government-guaranteed obligation. It is different from the section 503 program. The issue with regard to the pollution control program is not whether some tax-exempt financing should be used together with a source of Government-guaranteed taxable financing. It is rather a question of direct guarantees of tax-exempts, which raises all those problems that I talked about.

Senator D'AMATO. Doesn't that go to the heart of the little conflict that we are having? Congress said, Congress legislated, and yet we have the Treasury going another way. We legislated IDB's for pollution control.

Mr. MEHLE. You will have to forgive me on that one. I am not prepared to discuss whether the SBA pollution control program presents a legal issue of the kind that I think you are alluding to.

Senator D'AMATO. Let me ask you if we couldn't go back and take a look at relaxing what is coming out of Treasury as it relates to pollution control bonds vis-a-vis IDB's.

Mr. MEHLE. I certainly will. I would like to point out again the distinction between the program which is the topic of this hearing and the SBA pollution control program. The 503 program involves financing with tax-exempt obligations which are not directly guaranteed together with financing by Government-guaranteed taxable obligations which are subordinated to the tax-exempts, and whether it is appropriate to mix these two sources of financing.

The SBA pollution control program, on the other hand, involves direct Government guarantees of tax-exempt obligations, so that it is different in kind from the section 503 program. We will have discussions about this, and I will get back to you on the issue.

[Subsequent information was received and follows:]

DEPARTMENT OF THE TREASURY,
Washington, D.C., October 22, 1982.

HON. ALFONSE A. D'AMATO,
Chairman, Subcommittee on Urban and Rural Economic Development of the Senate Small Business Committee, Washington, D.C.

DEAR MR. CHAIRMAN: I am pleased to respond to the questions concerning the SBA pollution control bond guarantee program which you raised during my September 28, 1982 testimony on the SBA section 503 program.

Under the pollution control bond program, SBA has the authority to guarantee the payments due under lease contracts or loan agreements entered into by small business concerns and State and local public bodies in order to acquire pollution control facilities. To finance such facilities, State and local public bodies have issued tax-exempt obligations secured by the SBA-guaranteed contracts or loan agreements. Thus, an effective Federal guarantee of these tax-exempt obligations has been provided. In accordance with the Administration's policy against such guarantees, since January 1, 1982, SBA has guaranteed only taxable pollution control financings.

Project financing under the section 503 program differs from the pollution control financings in that the 503 projects are joint financing ventures and are financed with a combination of SBA-guaranteed obligations and other obligations which are not directly guaranteed by SBA. Thus, the proposal that the SBA-guaranteed obligations be on a parity basis with the other debt obligations in the event of default would prevent the indirect SBA guarantees of tax-exempts that would have occurred if the SBA-guaranteed obligations were subordinate to other, tax-exempt, obligations. Since pollution control projects are not joint financing ventures, the parity approach that we recommend for the section 503 program would not resolve the problems of Federal guarantees of tax-exempts under the pollution control program.

There is another approach which would resolve our concerns with the financing of the pollution control program and at the same time permit State and local public bodies to participate in the program. With my testimony I included a list of twenty-four statutes which preclude Federal guarantees of tax-exempt obligations. On that list there are sixteen statutes which authorize Federal guarantees of taxable municipal obligations, thereby providing a legislative solution to the problems created by Federal guarantees of tax-exempt obligations. Specifically, these statutes provide that the interest paid on municipal obligations and received by the purchaser will be included in gross income for the purpose of chapter 1 of the Internal Revenue Code, as amended. The Administration would have no objection to amending the statutory language authorizing the pollution control program to provide that municipal obligations which are issued for pollution control purposes and guaranteed by SBA are taxalbe. The financing costs of the small businesses utilizing the program would thus be reduced by the Federal guarantee, which for the less creditworthy projects may well be worth more than the value of tax exemption. While this approach would not combine the benefits of the Federal guarantee and tax exemption, it would permit participation in the program by small businesses who are now effectively precluded from the market place because of lack of credit standing.

If I can be of any further assistance, please let me know.

Sincerely,

ROBER W. MEHLE,
Assistant Secretary, Domestic Finance.

Senator D'AMATO. Again, I think you must understand that this is a difficult bond to sell because it is not a revenue-producing bond, and so there is not a product that is created at the end.

Mr. MEHLE. Right.

Senator D'AMATO. I think that if we say that this is the national purpose and the national goal, we should be in a position to attempt to assist these small businesses who are, in many cases, under directive to clean up, et cetera, to make the kinds of capital improvements dealing with pollution that otherwise they are not able to do.

And so what I am saying is that you cannot legislate some guy to do it on one hand and then deny him the wherewithal. Of course, there are those who say, Well, simply the law of supply and demand; he goes out of business. Sure, when he goes out of business, then we've got some guy over in Taiwan who has no pollution laws, and his little company or factory is turning them out, and we are knocking off people; we are knocking off jobs here.

So I think we have got to be practical. If we are going to start this law of supply and demand, I will tell you what is going to take place. If we adhere to this, if we listen to the strict economists who say only the strongest survive, we are going to have a lot of Korean companies, Japanese companies, companies in Taiwan and other places. They are all going to survive, and we are just going to be the big users. Then we will be only a service industry. Of course, our service industry is picking up aliens, illegal aliens, and they are doing the servicing.

Senator HUDDLESTON. Well, I think the figures that came out on our balance of trade last month showing a record set ought to give us some incentive to try to find some way to keep our people in business.

Senator D'AMATO. Roger, thank you for coming in, and I would ask if you could get a memo to us on that other point.

Mr. MEHLE. I will.

Senator HUDDLESTON. I have no more questions.

Mr. MEHLE. Thank you, Senator.

Senator D'AMATO. Our third panel consists of Mr. Steve Gurian, president of the Long Island Certified Development Corp.; Scott Berman, president of the Lawrence Avenue Development Corp. from Chicago, Ill.; Roger Peterman, president of the Commonwealth Small Business Development Corp., Frankfort, Ky.

Mr. Gurian, Steve?

Mr. GURIAN. Good morning, Mr. Chairman.

Senator D'AMATO. First, again let me say to all of the witnesses that we will receive into the record, as if read in their entirety, your statments, and if you would care to make a synopsis, that would be very much appreciated.

STATEMENT OF STEVEN D. GURIAN, PRESIDENT, LONG ISLAND DEVELOPMENT CORP.

Mr. GURIAN. Thank you.

I think I will address myself immediately to the statement that you had made when you opened this session, and that is, the underutilization of the program of $250 million budgeted and only $70 million used. You went from that into what appears to be the highlight of the underutilization cause, which is the industrial revenue bond. Since there has been a great deal of comment already with regard to it, I would just like to make one particular remark on the industrial revenue bonds.

It may be a cliche by now, but the ones who really enjoy the tax benefit and the ones who are able to market and sell the bonds seem to be those organizations which really do not need that additional inducement, in the sense that these are the larger, more solid organizations that have excellent banking relationships with accounts that provide revenues in the form of compensating balances, and so on, to the banks.

The ones who really do not have access to it are, by definition, the smaller small businessmen. The smaller business usually can sell only a part of the bond and cannot obtain the 90-100 percent financing. With IDA 503 parity may be a step, an excellent step, in the right direction. I certainly would endorse it, provided however as you Senator seem to imply, we should leave the door open, just in case it does not work out and to permit 503 subordination, as was the intent of the legislators at the time of introducing the bill which eventually became law. I will leave the balance of tax-exempts to others who have been presenting their papers and to those who will follow.

I would like to go on to some of the other causes of underutilization. Senator, as you pointed out in your opening remarks, some of the certified development corporations are of recent vintage and still have not had an opportunity to get their feet wet. That is true. Only time will correct that.

There are, however, a number of other, significant restrictions that I consider to be of significance. I think the one point that Mr. Sanders made in his comments this morning was that there was considerable cautious approach prior to the issuance of a certification of a CDC.

I believe it is the tenor of the government at the present time to pass on to the private sector—and certainly the CDC is the private sector—that which they can do, and leave to the government that which only the government can do.

In those regards, I would like to address myself to the possibility of providing, either legislatively or by the SOP, a new category of Certified Development Corp., in the category of a preferred lender, as is being considered in the 7-A program.

At present, we have a certified lender program, where lenders who have been in the program for some time and have demonstrated ability, maturity, and understanding of the program can be certified so that some of the administrative burden of marketing, loan decision, and portfolio management, investigation can be passed on to the certified lender. Thus relieving SBA of these functions and creating additional facility for oversight.

I believe that the certification process—the very words used in the SOP which describe the qualifications for certification—demand a very high degree of administrative professionalism; as well as involvement from the public and private sector; and the financed institutions of the community. The development corporation, LIDC, from Long Island, N.Y., has both county executives as members of the board of directors plus other members of the county government. We have bankers. Don Gallagher, sitting behind me, is a member of the board. We have members of industry, and the Long Island Association. The professions—accounting, law, real estate. Labor and civic organization are also represented.

The governing management body of the CDC are qualified, professional, mature, well-meaning people. Certainly they have the capability of discharging the obligations and responsibilities that are set forth in the regulations and the SOP's as to how a certified development corporation should perform.

Specifically, I am addressing myself to those development corporations who, by virtue of time, experience, and success, with monitoring from the SBA can act on its own and have those actions merely reviewed by the SBA. At present the CDC only recommends SBA approval. This procedure can and does take months. Even though we have had exceptions, the general rule is that it takes a long time. By the time we get the approval, the need is oftentimes diminished to the point where it is completely negated. A small business cannot really act on or use the financial assistances of the approval, since time is always of essence.

The development corporation on Long Island, which is one of the leaders in the country, has had instances where applications have been disapproval after our own board has approved it. Our board has four members who are well experienced credit officers from leading banks in the community. After this group approves the credit. A executive loan committee reviews it. The board of directors reviews it. Only then does it go to the SBA. A decision contrary to that which we arrived at, implies an ambiguity in the SOP for example, a single facility does not really have a clear definition. What has been approved in Alabama has been disapproved in New York—a similiar building for the same intended purpose.

Senator D'AMATO. That means you have got to work a little harder to get that information to the SBA people.

Mr. GURIAN. Sometimes we cannot, Senator.

Senator D'AMATO. I cannot believe, Steven, that someone of your persuasiveness could not even cut through the bureaucracy of SBA, particularly since they tell me that they are very amenable to applications that come from our home town. [Laughter.]

Mr. GURIAN. True, true. I agree with the persuasiveness; I agree with the home town. However, as a practical matter, cutting through could take 4 or 5 months or longer.

Senator D'AMATO. I understand.

Mr. GURIAN. Right. Now, we have other points that——

Senator D'AMATO. Steven, I am going to ask you to hold. I am going to ask Mr. Berman, if he would, to go ahead, and we will get back to you.

Mr. GURIAN. All right, fine.

[The prepared statement of Mr. Gurian follows:]

STATEMENT OF STEVEN D. GURIAN

OPENING STATEMENT

I am the President and Executive Director of the Long Island Development Corporation, a Section 503 certified development company for Nassau and Suffolk Counties in New York. I have been involved with SBA programs for over twenty years as President and Executive Director of the Long Island Economic Development Corporation (a local development company under SBA's Section 502 program) since 1964 and as President of The Money Store of New York,Inc., a participant in SBA's Certified Lender Program.

I also serve as consultant to Nassau County on matters involving their industrial development agency, the New York Job Development Authority, and other governmental programs. Through these activities I have been involved in most aspects of government supported economic development assistance funding. Based on this experience I herein offer my thoughts on the 503 program and its implementation.

REMARKS

It has been stated that the funds available for use under the SBA 503 program have been underutilized in this past fiscal year and therefore the allocation should be less for fiscal 83 than it was for fiscal 82.

It is respectfully submitted that there are specific reasons for the failure to exhaust the 1982 allocation and that these reasons need not exist for fiscal 1983. The failure to use all of the allocation should therefore, not dictate a smaller allocation in 1983.

1982's budget was not fully utilized for three basic reasons:

(1)503 is still a relatively new program and,as such is just "getting off the ground." As more people become aware of the program and as a successful "track record" develops, it may be expected that usage will increase. The funds should be there to supply the increased demand;

(2)Economic conditions in the past year have not permitted the type of financial planning and action for which the program is intended. Presently, there is not much demand for acquisition of capital assets. As economic conditions change, the demand will increase and 503 funds should be present to answer this demand;

(3)Probably the most common reasonsfor nonutilization of the program are difficulties of the program itself-restrictions imposed upon the program which operate to (a) exclude from its use many small businesses which should benefit from it and (b)frustrate those which do attempt to use the program. These restrictions are impinging on the usefulness of the program and serve to negate the programs intended purposes.

RESTRICTIONS ON 503 WHICH SERVE AS IMPEDIMENTS TO ITS PROPER USE

Three basic restrictions will be discussed infra: (1)inability to combine 503 with tax exempt financing; (2)burdening SBA with functions which might better be served by the local development corporations; (3)the inflexibility of the Federal Financing Bank in meeting the needs of the program.

INABILITY TO COMBINE 503 AND TAX EXEMPT

SBA's current Standard Operating Procedures (hereinafter referred to as "SOP")prohibit participation of Section 503 debentures in projects where part of the financing derives from tax exempt funds. This is inconsistent with the enabling statute and interpretive regulations.

SBA's SOP states that "SBA shall not participate in projects if their other source of financing includes or is collateralized by tax-exempt obligations." SBA SOP Section 50, No.22,Rev.A,2/5/82, page 36, paragraph 23. The SOP uses as alleged support for this pronouncement a Report of the Committee on Federal Credit Programs to the President dated Feb.11, 1963 which recommended that no program in the future be authorized which involved guarantee of tax exempt obligations. See SBA SOP ,Appendix 11, Section 50, No.22, 2/5/82 ,page 149.

It is respectfully submitted that the SBA's SOP is inconsistent with and thus superceded by the enabling statute and regulations. The enabling statute for the SBA 503 program- Title 15 U.S. Code Section 697 (1980)- does not specifically refer to participation with tax exempt financing. The Conference Report accompanying the bill however, states clearly that "SBA should not disapprove the guarantee of any debenture, or any loan made with the proceeds of a debenture issue, solely because the proceeds would be used in a project whose other sources of financing include, or are collateralized by,tax exempt industrial revenue or development bonds." Conference Report on Small Business Development Act of 1980, report dated 6/12/80.

This report and its dictates regarding tax exempt financing were followed by the SBA in issuing its interpretive regulations. Clearly, the SBA, in publishing regulations implement the statute, felt it proper to interpret the statute to allow participation with tax exempt financing in accordance with the intent of Congress as expressed in the Conference Report.The SBA regulations initially enacted in 1980 remain the same as of this reporting: "Participation with tax-exempt obligations. SBA may participate in projects whose other sources of financing include or are collateralized by tax exempt obligations.Further, loans made with the proceeds of 503 debentures may be subordinated to such obligations." 13 Code of Federal Regulations Part 108.503-4(c).

Apparently, the drafters of the SBA SOP ignored the clear language of the regulation which paralleled the Conference Report of 1980 accompanying the statute- in favor of a 1963 Report to the President. Said 1963 Report was, at best, only a general recommendation regarding all federal credit programs and was superceded by the specific recommendations made regarding the 503 statute. Further, the suggestion of the general 1963 Report to the President was not even followed-other federal programs do permit and in fact encourage participation of tax exempt financing with other federal loan programs (eg. HUD's UDAG program, FmHa programs).

Aside from the current SBA policy against participation with tax exempt financing being inconsistent with the statutory authority- the policy is a detriment to utilization of the 503 program and denies assistance to those most in need and who were intended to benefit from the 503 concept.

The goal of the 503 program is to stimulate and induce plant expansion by small businesses in order to create jobs and otherwise benefit the community. Permitting combinations of tax exempt financing and 503 could be an excellent tool for providing this stimulus and inducement. This concept is best demonstrated by explaining the nature of the tax exempt bond. An industrial revenue bond is issued by a state or local industrial development agency. It is generally backed by the full faith and credit of the business whose project is being financed. A bond is always for the total project cost. The most desirable financing results when the total bond is purchased. In such cases, the rate (generally about seventy percent of prime) and long term nature of the bonds provide a very favorable financing condition for the business permitting orderly discharge of the debt obligation over time. Large companies with good credit and banking relations have no problem getting the total bond purchased by the private sector. Small businesses (which are the intended beneficiary of the SBA's programs) do not have those kinds of relations and generally cannot find a purchasor for the total amount of the bond. When a small business finds a purchasor, it is generally limited to fifty to sixty percent of the bond.

This means that the small business must turn to the private sector for financing of the balance of the projects cost. Since industrial revenue bonds must be in first position, such financing must be in second position.

Second mortgage money for industrial /commercial projects is not easy to obtain. Further, the rates on private sector second mortgage funds currently average anywhere between fifteen and twenty percent and such funds are not available for long terms. The alternative of private sector second mortgage funds is not in keeping with proper financial planning for expansion since the combination of high interest rate and very short term introduces onerous debt service. The small businessman is thus denied the tenable rate and term of industrial revenue financing. Such rate and term is available to the small businessman ,however, if he can fund the shortfall (the difference between the fifty or sixty percent financed by the industrial revenue bond and the project cost) with a 503 debenture. In such case, the blend rate is attractive and there is the advantage of the long term which permits orderly discharge of debt obligations and "liveable" debt service during early years of payback.

If the 503 debenture was available to fill the gap for the small business' financing of expansion projects, a major incentive would exist for such expansion.

This combining of tax exempt financing with SBA participation has taken place successfully under SBA's 502 program. Under 502, the local development companies in New York had an excellent relationship with the New York Job Development authority which is funded from the sale of tax exempt bonds. In many instances the JDA could not supply the small business with enough funds to complete the project. The SBA, under the Section 502 program through its local development companies, supplied the balance of the funds needed. This mingling of programs permitted many small businesses to expand. Absent the combined favorable rate, terms and availability of money, they would not have been able to do so. It would seem there is no reason to distinguish the 503 from the 502 program where it has been demonstrated that tax exempt financing can coexist harmoniously with SBA participation.

It is interesting to note that the combining of 502 funds with New York Job Development Authority funds has existed since at least 1964. Obviously, the SBA chose in that instance to ignore the recommendation of the 1963 Report to the President (cited infra) that federal credit programs not be combined with tax exempt financing.

SBA IS PRESENTLY BURDENED WITH FUNCTIONS WHICH MIGHT BE FULFILLED BY THE CERTIFIED DEVELOPMENT COMPANIES

Currently the 503 program operates in the following manner: an application is reviewed by the certified development company. If it is approved by the development company's board of directors ,it must then be forwarded to the SBA district office for review and approval.Upon approval by the SBA, the development company may close the loan. There is a two part closing. First, there is a closing where all the legal documents are executed. The development company then submits the documents to the SBA which guarantees the debenture and forwards it to the program's Central Fiscal Agent. Next, the Central Fiscal Agent sells the debenture to the Federal Financing Bank, sales taking place once per month, Upon sale, the Central Fiscal Agent receives the proceeds and distributes them.

The current manner of processing sometimes yields a conflict in the interpretation of the statute, regulations and SOP which results in an excessive amount of time to render approvals and often disapprovals which are at odds with community requirements.

It is this administration's goal to lessen the reliance on government and increase reliance on the private sector. It is submitted that a vehicle for achieving same is available in this program. The certification process for certified development companies is stringent. It is necessary that a development company show that it membership is representative of the community and its interests, that its board of directors and staff are competent and have the capability to execute all the functions required of them. Since the SBA requires these attributes of its certified development companies, it is suggested that there should be a greater reliance on the certified development company in the processing, closing and servicing functions. This would take a burden off the SBA and its limited resources and place it on the community which desires the use of the program.

The method suggested is that of granting preferred lender status to certified development companies following a designated period in which the development company has demonstrated the ability to perform as intended. A two year period of reasonable activity is suggested as a sufficient time in which a development company can be assessed. As a preferred lender (similar to the preferred lender category of the SBA's bank guaranteed program) the development company would have the authority to process, market,service,liquidate, etc. utilizing the financing and development tools available in the community to achieve the end result intended by Congress. The SBA would then become ,not an approving authority, but an auditing authority. The final determination being made by the development company will also decrease processing time, in addition to reducing the government's posture.

In turning over the administrative role, the SBA need not fear that the regulations will not be applied . The SBA aside from auditing the development company, can withdraw the preferred lender status or decertify the development company at any time.

In addition to placing the administrative role on the development company, it is suggested that the SBA issue a blanket debenture for a bloc of funds. In this way, the development company can, after choosing an appropriate time for the sale, sell the bloc, receive the funds and have them available for lending the small businesses as applications are approved. This would eliminate the two closing system. More importantly , it would aid the small business concerns in financial planning. Presently, the small business, at the time of legal closing, does not know what rate he will receive. In effect, he is taking a gamble. In one instance, a small businessman closed at a time when the rate was about fourteen percent. When the debenture was sold the next month, the rate had increased to fifteen percent. This possibility would be eliminated under an allocation of a bloc of funds because the rate would be in place at the time of closing.

INFLEXIBILITY OF FEDERAL FINANCING BANK

It is respectfully submitted that the small business concerns would be benefitted by allowing the debentures to be sold to the private sector as well as the federal financing bank. Currently, the debentures must be sold to the FFB. The sales take place only once per month, on the Wednesday of the first full week of each month. This decreases the flexibility necessary to achieve best of market conditions. If the development company (as preferred lender) or the SBA had the option of selling to the private sector, they could pick the time when interest rates are best and seek the best purchase terms. Also, if the development company is permitted to sell debentures in a bloc to the FFB or private sector ,better terms may result.

Currently, the small businessman who wishes to prepay his debenture must pay a substantial prepayment penalty. In one case, the small business received a $123,000 loan and less than five months later repaid over $140,000. If the debentures could be sold to the private sector, they could be sold on a "no prepayment penalty" basis just as other SBA paper is currently marketed. This would greatly benefit the small business and eliminate one more disincentive to using the program.

All of these items (ability to sell debentures to the private sector, bloc debentures, ability to choose the most appropriate time for sale under best of market conditions)would serve to stimulate usage of the program.

CONCLUSION

As the 503 program matures and economic conditions change- if we remove the impediments to the utility of the program and amend it to respond to the peculiar needs of the small businessman in today's economy- 503 financing can serve its intended purpose- as a major tool óf expansion for qualified small business concerns and a source of new jobs and continued economic growth.

Respectfully submitted,

Steven D. Gurian

RG/np

STATEMENT OF SCOTT Z. BERMAN, PRESIDENT, LAWRENCE AVENUE DEVELOPMENT CORP.

Mr. **Berman**. Thank you, Senator. My name is Scott Berman, and I represent the Lawrence Avenue Development Corp. in Chicago, the Chicago Association of Neighborhood Development Organizations, and the National Association of Development Co's.

We are here today both to praise and criticize the 503 program. The promise and potential of the 503 program are great, but the implementation of the program by the SBA, as we have been discussing this morning, is less than great.

Our CDC's are working to improve their communities by revitalizing the economic sector within the community. That economic sector is composed mostly of small business people. We want this program to work for those small business people.

It has already provided 220 businesses nationwide with $64 million in financing and created more than 19,000 jobs. But these figures indicate that only a small dent in reversing neighborhood economic decline is being made by the 503 program, and the volume is far short of the volume that our CDC's are capable of packaging.

In an accompanying report, we have discussed 36 specific problems and recommendations for change in the 503 program that will give it greater utility and marketability. That report was authored by the Technical Issues Committee of NADCO, on which I serve as chairman.

Four of these recommendations deserve special note. First, the alter-ego rule disallows loans to otherwise qualified applicants who have acted in their companies' best fiscal interests by separating the ownership of the business from that of the business's depreciable assets building and equipment. This standard operating procedure, SOP, could easily be changed by requiring the controlling interest in the alter-ego to be the same as that of the small business, even though ownership was not necessarily identical.

Second, SBA's SOP's prevent the subordination—we have been talking about IRB's all morning—of 503 debentures to first-mortgage financing that is tax exempt, most notably IRB's. Not only is this different from other Federal programs such as UDAG's, but it directly affects our smaller businesses who could most benefit from this blend of IRB's and 503's and whose projects are not of UDAG scale.

To touch briefly on the issue of parity that was suggested earlier, as an attorney, it would not be possible or practical in all States to record two liens simultaneously that would share the same status on a loan. I think one would have to be subordinated to the other in spite of agreements that might be made from one secured party to the next.

Third, the SBA currently is rejecting their own standard of loan performance as it relates to jobs. Only newly created jobs are currently considered by the SBA, while equally important retained jobs are not. The SBA should again recognize, as it once did, as we all do, that a job retained in our community is one more that will not have to be newly created.

And, fourth, many SBA field offices have required the principals of the small business to meet the 7-A net worth restrictions in the

502 projects rather than the more realistic 503 requirements; that is, giving up all of their net worth into the project.

Even if these and the other recommendations in our report are implemented, we will continue to have difficulty marketing this program to distrusting small business people if it takes 6 to 8 weeks after the submission of a package to receive the SBA's financing authorization. And 6 to 8 weeks, I think, is generous. It has been taking 8 to 12 weeks in many cases.

Most conventional lenders can issue a letter of commitment within 14 days. CDC's must be given greater authority to make credit decisions. As Mr. Sanders said earlier this morning, the certification that the SBA grants to our CDC's is a thing of value, something that the SBA respects highly. Unfortunately, they do not respect it highly enough to allow us the credit decisionmaking that would allow these loans to move more smoothly and only involve the SBA in an oversight capacity.

More staff must be trained by the SBA to review 503 applications at the district offices. In Chicago, for example, there is only 1 trained 503 loan agent for some 15 CDC's that are filing loan applications at the Chicago office. Consequently, creditworthy applications are needlessly delayed.

And, finally, ambiguities must be eliminated between the SBA's 503 regulations and the SOP's, and both should change as infrequently as possible. They change, as you are probably aware, Senator, almost daily, and both the SOP's and the regs change so quickly that they are not always in agreement with one another. Hundreds of good loans are lost because of a business person's frustration at constantly being forced to redraft his package to comply with ever-changing and ambiguous SOP's and regulations.

It is becoming increasingly difficult for us to convince small business people to apply for a 503 loan when up-front legal, accounting, and packaging costs climb relative to the program's complexity and ambiguity.

The SBA 503 program is currently working at only about one-third of its potential, and our communities need more. We welcome this opportunity to work with your committee and its staff and with the SBA to make this program work to its fullest potential.

Senator D'AMATO. Thank you very much.

Mr. BERMAN. Thank you.

Senator D'AMATO. Mr. Peterman.

[The prepared statement of Mr. Berman follows:]

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Serving The Nation's Certified Development Companies

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STATEMENT OF

SCOTT Z. BERMAN

President
LAWRENCE AVENUE DEVELOPMENT CORPORATION
Chicago, Illinois

Vice-President
CHICAGO ASSOCIATION OF
NEIGHBORHOOD DEVELOPMENT ORGANIZATIONS

Vice-President
NATIONAL ASSOCIATION OF DEVELOPMENT COMPANIES
Washington, D.C.

Committee on Small Business
U. S. Senate
Washington, D.C.

September 28, 1982

1050 - 17th Street, N.W. · Suite 900 · Washington, D.C. 20036 · 202/296-6212

Good Morning. My name is Scott Berman. I am the President of and Attorney for the Lawrence Avenue Development Corporation (LADCOR) in Chicago, the Founding President of the Chicago Association of Neighborhood Development Organizations (CANDO) and the Vice-President for Technical Issues of the National Association of Development Companies (NADCO). NADCO is the professional trade association of SBA 503 Certified Development Companies (CDC's). NADCO's members include the largest, most active, and most sophisticated CDC's in the nation.

We are here today both to praise and to criticize the SBA 503 program. The members of our Certified Development Companies (CDC's), and businesses who have received 503 loans are enthusiastic about the benefits that the 503 program has brought to our communities: new businesses locating in areas previously thought to be less than desirable; existing businesses showing faith in an area by renovating and expanding; increased public and private investment near 503 projects; creation and retention of jobs. The promise and potential of the 503 Program are great -- the implementation of the program by the SBA is less than great.

I believe that I can best explain our concerns regarding the 503 Program by acquainting you with the Lawrence Avenue Development Corporation (LADCOR) in Chicago and its relationship with the SBA over the past six years. LADCOR is an active CDC which is representative of most of CANDO's and NADCO's membership. LADCOR's purpose is to create and retain jobs and to develop and revitalize the commercial and industrial economy of a nine square mile section of the northwest side of Chicago. LADCOR was begun in the mid-1970's by a consortium of community groups under the umbrella of the North River Commission, banks, savings and loans, churches, synagogues and schools. It was, and is today, funded by those members, loan packaging fees, and a small Community Development Grant from the City of Chicago. I served as LADCOR's first Executive Director. In its early days, prior to the SBA's 503 or predecessor 502 program, LADCOR packaged loans for small businesses and arranged financing through local banks. In September of 1976, LADCOR was named by then SBA Administrator Mitchell Kobelinsky as one of the first Local Development Companies (LDC's) in the nation, certified to operate under the newly created SBA 502 program. We at last had a long-term, incentive financing program to use as a tool for the economic revitalization of our neighborhood. We worked closely with our local banks and the Chicago office of the SBA to make the program work. Rule revisions occurred almost monthly, and appropriations were never sufficient to meet the demand generated by an ever-increasing number of LDC's in Chicago and in the nation. Our District SBA Director, Jack Smith, worked tirelessly with us and with the National Development Council to streamline procedures and market this complex, but valuable program to small, distrusting businesspeople. LADCOR was trusted and respected by the businesspeople, the banks, and the SBA and we became a quasi-field service office of the SBA. From 1976 to 1981 LADCOR packaged 3.5 million dollars in SBA direct and guaranteed loans and conventional loans, which generated more than 8 million dollars in additional public and private investment, catalyzed major developer investment in excess of 15 million dollars, and retained or created 500 jobs.

In 1980, after much discussion between the SBA, the LDC's, and the LDC's coalition organizations such as the Chicago Association of Neighborhood Development Organizations (CANDO) and the National Association of Development Companies (NADCO), which was then in formation, the new 503 program was created to resolve the major problems of the 502 program: insufficient funding, everchanging regulations and standard operating procedures (SOP's), and lengthy bureacratic delays for loan authorization and closing.

How have we fared after almost two years of the 503 program? Not badly. Nationwide, Certified Development Companies, such as LADCOR, have packaged 250 SBA 503 loans worth 64 million dollars, which have created more than 19,000 jobs. The debenture funding procedure of 503, while cumbersome, has provided more than sufficient funding. In Chicago, the City jointly sponsors with CANDO the Lenders Participation Program, wherein 25 banks pledged 70 million dollars for loans compatible with the 503 program. But we have not been able to satisfactorily market the 503 program because of the unresolved problems of lengthy delays and everchanging regulations.

Delays are inexcusable in a commercial loan program. A bank can decide whether or not to finance a proposal, and issue its letter of commitment or rejection within 14 days. It takes SBA an average of four weeks to reach a decision on a 503 package and an additional two weeks to issue a letter of authorization. Our small business borrowers, after undergoing the time-consuming process of assembling all of the documents required by the SBA, cannot wait an additional six weeks to receive their authorization. And when a borrower receives his financing after such a delay, word spreads quickly through the community of the difficulties and the delays.

Three actions by the SBA could greatly reduce the delays. First, more staff at SBA's district offices must be trained to review 503 applications. In an office as large as Chicago, only one loan officer is capable of reviewing 503 packages submitted by fifteen CDC's. Second, CDC's must be given greater authority to make credit decisions. If CDC's were afforded the respect that their certification implies, SBA review time could be greatly abbreviated.

Third, ambiguities should be clarified between the regulations and the SOP's, and both should change as little and as infrequently as possible. Delays could be greatly reduced and the number of resentful borrowers greatly diminished if CDC loan packagers and SBA loan officers shared a common interpretation of the requirements of the program, and had faith that their understanding would not change from week to week as new SOP's and/or regulations were released.

In addition to the general problems that I have been discussing there exist numerous specific impediments within the SOP's and regulations to a completely successful 503 program. Submitted with my testimony today is an appendix which lists over 30 recommendations for procedural changes in the 503 program. It was authored by NADCO's Technical Issues Committee, which is composed of thirteen Economic Development Professionals from CDC's across the nation who have experienced each of the problems for which a procedural change is recommended. I serve as the Chairman of that committee. We will be pleased to discuss any of our recommendations with you and your staff.

Thank you again for giving us this opportunity to present testimony today, and to discuss our recommendations for changes with you. We, of course, appreciate your ongoing support for this important program and your concern for its efficient operation.

REPORT OF THE TECHNICAL ISSUES COMMITTEE
NATIONAL ASSOCIATION OF DEVELOPMENT COMPANIES
ANNUAL MEETING AT WASHINGTON D.C.
JUNE 10-11, 1982

I. INTRODUCTION

The Technical Issues Committee of the National Association of Development Companies consists of the following members:

CHAIRMAN: Scott Berman
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Chicago, Ill.

MEMBER: Jim Baird
Bay Area Employment Development Corp.
Napa, Cal.

MEMBER: Liz Butler
New Orleans Citywide Development Corp.
New Orleans, La.

MEMBER: Lynn Cunningham
Greater Southwest Development Corp.
Chicago, Ill.

MEMBER: Al Emory
St. Paul Citywide Development Corp.
St. Paul, Minn.

MEMBER: Patricia Fening
Columbus Citywide Development Corp.
Columbus, Ohio

MEMBER: David Gontarek
St. Paul Citywide Development Corp.
St. Paul, Minn.

MEMBER: Art Goodman
San Diego County LDC
San Diego, Cal.

MEMBER: Kelly Harris
Provo Development Corp.
Provo, Utah

MEMBER: Tom Hoover
Columbus Citywide Development Corp.
Columbus, Ohio

MEMBER: David Main
Dayton Citywide Development Corp.
Dayton, Ohio

MEMBER: Judith McGough
Allentown Economic Development Corp.
Allentown, Penn.

MEMBER: Joe McGraw
Scioto Economic Development Corp.
Portsmouth, Ohio

The Committee on behalf of the Board and the membership requests SBA consideration of the changes recommended herein in order to improve the operating capability and effectiveness of the SBA 503 Development Company Program.

II. ALTER-EGO

The present alter-ego rule excludes many viable businesses and projects which meet the intent of the 503 program, but which are declared ineligible based on technical non-compliance. SOP 50-22 Chapter 4, Paragraph 15 (a)(iv), (page 28 of the SOP) requires:

> "the ownership interests in the applicant (alter-ego) shall be completely identical with and in the same proportion as the ownership interests in such small business concern, and the identity of interests shall remain unchanged until the loan is repaid in full or SBA sooner gives approval to a change."

This rule disallows alter-egos who for any reason have slightly differing SBC stock ownership and real estate ownership compositions. Some companies reward their young and promising managers with stock or partnership interests in the company without giving them a share in real estate (or vice versa). SBCs who are second or third generation businesses often pass SBC stock ownership to those heirs who operate the business and real estate ownership to a broader group of heirs. The result is to have slightly different SBC and alter-ego entities, both of whom are fully controlled by the principals of the SBC.

SOP 50-22 Chapter 4, Paragraph 15 (a)(iii), (page 28 of the SOP) requires:

> "The proceeds of the loan to be used to benefit directly such applicant (alter-ego) will be used only to acquire or improve real or personal property for the exclusive use of such SBC."

This provision prohibits the SBA from assisting any alter-ego which is acquiring an existing building some of which may be leased out because it is not suitable for the SBC's needs (e.g. the second floor of a retail SBC, etc.).

The Technical Issues Committee requests that both provisions be deleted and replaced with a provision similar to the following:

> "The controlling interest of the alter-ego should be held by the same principals who maintain the controlling interest in the SBC, but such ownership interests need not be identical nor in the same proportion. The test for eligibility will be one of benefit inuring to the alter-ego. So long as the rental income from the project to the alter-ego entity does not exceed an amount sufficient to amortize debt service, and to pay property taxes, insurance, normal maintenance and management costs associated with property ownership, an alter-ego substantially controlled by the principals of the SBC will be considered an eligible borrower. Cross guarantees and the joint signatures of both the SBC and the alter-ego on the note will adequately secure the SBA."

Attached in Exhibit A are several examples of projects which have failed to comply with the SBA alter-ego rule.

III. "ADVERSE CHANGE" CERTIFICATION BY INTERIM LENDER

SOP 50-22, Chapter 6, Paragraph 25(a), (page 37-38 of the SOPs) requires:

> "The authorization should contain the following provision: Interim financing for total construction is to be provided by (Lender) and prior to issuance of the debenture, CDC and SBA must be satisfied that construction has been completed in accordance with final plans and specifications, that no unpaid labor or material liens exist, that construction costs have not exceeded ($) project cost, that there exists a small business concern with the ability to repay its obligation to the CDC, and that such concern has not suffered a material adverse change since the date of this authorization".

This provision has been interpreted in SBA Field Offices that the Interim lender must make these certifications. The Architects Certification of Substantial Completion will certify that the project has been completed in accordance with the final plans and specifications. Title insurance will protect the SBA from unpaid labor or mechanics liens, and the SBC's attorney may certify that the project cost has not exceeded the authorized level or that additional equity has been provided to cover any increases. The existence of an SBC with the ability to repay its obligations is a credit question, not a legal question for an interim lender. The "adverse change" certification should be made by the SBC's attorney. The Technical Issues Committee recommends that the entire provisions be deleted.

IV. SOURCE OF INTERIM FINANCING

SOP 50-22, Chapter 6, Paragraph 25(b), page 38 of the SOPs, requires that "sources of interim financing shall be limited to regulated lending institutions." This provision may substantially increase the cost of the project to the borrower because it prevents lower cost interim financing from being used in the project. Some CDC's have access to "CD float" or EDA Title IX Revolving Loan funds, and some SBC's may be able to squeeze some cash out of operations for a short period of time. This cash probably will be needed for working capital once the project is completed and inventory stocking begins or growth in sales occurs as a result of the plant expansion. Prohibiting these two legimate sources of interim financing injures the SBC. The SBA may adequately protect itself by requiring a Title Insurance Company to monitor construction advances. The Technical Issues Committee recommends this provision be deleted.

V. INTERIM FINANCING ON MACHINERY AND EQUIPMENT

SOP 50-22 Chapter 6, Paragraph 25(c), page 38 of the SOPs, permits sale of a debenture without an interim lender's loan if "the project cost consists only of the purchase of an existing facility." In addition to this provision, a debenture sale should be permitted in those situations in which construction has been completed and the only remaining use of funds before the project is fully completed involves the acquisition of machinery and equipment, the cost of which is small in relation to total project cost (say 15-20% of total project cost). In such cases, the interim lender should be required only until construction is completed after which time the debenture may be sold. The debenture proceeds earmarked for machinery and equipment should be deposited into an escrow account at a regulated financial institution. Any balance remaining in the escrow account after the acquisition of the machinery and equipment may be refunded to the SBC so long as the remittance does not exceed 2% of the debenture proceeds. Any amount remaining in escrow in excess of 2% should be recaptured as an addition to the Reserve Account held by the CFA. The Technical Issues Committee recommends the adoption of such a provision.

VI. TEN YEAR MACHINERY AND EQUIPMENT DEBENTURE

Job creation and business expansion includes projects which consists solely of machinery and equipment acquisition. For projects which involve only machinery and equipment, a 10 year 503 debenture is needed to make the CDC program effective. In situations involving only M&E, the SBA should permit the first mortgage lender's loan to be seven years (instead of the normal 10 year minimum). The Technical Issues Committee recommends the adoption of a 10 year machinery and equipment Debenture with a 7 year First Mortgage clause. The 10 and 7 year provisions should exist on M&E projects only.

VII. PRIVATE LENDER DEFINITION AND RESTRICTIONS

The definition of a private lender includes legitimate real estate mortgage financing companies who are major sources of credit for SBCs. The restrictions placed upon the private lender in the SOP 50-22, Paragraph 20b, page 31.3, require that "the private lender not have a pecuniary interest in, or relationship to, the SBC receiving assistance, i.e., the owners, associates, or relatives to the SBC may not provide the first mortgage non-federal source of financing." Such a restriction insures a legitimate "arm's length transaction" between lender and borrower and is fully supported by the Technical Issues Committee. Once the arm's length transaction is established, however, the other onerous restrictions on the private lenders are unnecessary and the restrictions imposed on the regulated lender and private lender should be identical. Specifically, mortgage finance companies should be permitted the same rate (prime + 2 3/4%), maturity (10 year minimum with prepayment permitted at the borrower's option), and collateral (senior to SBA) as those afforded the regulated lenders. These changes will permit mortgage finance companies to participate in 503 more fully while simplifying the program operationally. The Technical Issues Committee recommends strict adherence to the "arms" length transaction" rule for private lenders while making the restrictions on regulated lenders and private lenders uniform.

VIII. TAXABLE EARNINGS ON THE RESERVE AND ESCROW ACCOUNTS

Because of the IRS ruling that interest on the Reserve and Escrow Accounts is taxable in the year in which it is earned, the Technical Issues Committee recommends that the earnings be refunded to the SBC on an annual basis. Should the IRS reverse its ruling, the earnings nevertheless should be refunded periodically (say every three years) because a refund of 50% or more at maturity is unnecessary and embarrassing to the Agency.

IX. CLARIFICATION OF "IN ANTICIPATION OF"

Confusion persists in the SBA Field Offices regarding what constitutes an eligible project cost if any funds have been expended prior to SBA approval of the project. SOP 50-22 Chapter 6, Paragraph 26 f(3) (page 42.1 of the SOPs) permits:

> "Repayment of bonafide, short-term interim financing when the proceeds of such interim financing were actually used for plant construction, conversion and the like and had SBA approval in writing. SBA shall be permitted to take-out short-term interim financing, provided the loan application is approved, if such financing had been in place no more than 180 days from the date the CDC receives written approval from the SBA."

The above paragraph is seemingly generous, but it has been operationally difficult to implement. Some field offices interpret the paragraph to mean that the "written approval" is in fact the authorization. Other SBA offices refuse to issue written approval letters because District Counsel believes that a written approval constitutes a guarantee by the SBA to fund the project regardless of any disclaimers to the contrary.

The substantive problem with the paragraph, however, lies in the manner in which SBC's pursue expansion. After thinking about expansion for a period of time, the entrepreneur impatiently moves ahead with the project. He/she may contract to purchase real estate, purchase M&E at auction, etc. Only after he/she has a better understanding of the total project cost does he/she seek out financing. Paragraph 26 f(4) does not permit the inclusion of these "normal" ways of pursuing expansion. Because neither the bank nor the CDC were privy to the expansion before it was commenced, all elements of project cost incurred by the entrepreneur are ineligible because it was not financed by a short-term lender and was not pre-approved by the SBA in writing. This paragraph obviously violates the spirit of 503. The SOPs need to permit specific flexibility and judgement on the part of the Loan Officer to include as a part of project cost those funds expended by the entrepreneur in anticipation of the overall project even though a short-term lender has not financed them nor were they approved in advance by the SBA.

The Technical Issues Committee recommends that language similar to the following be adopted for the SOP: "Loan Officers may include in eligible project costs, funds which were expended by the SBC up to 180 days prior to the submission of a 503 application to the SBA provided the use of such funds can be verified as being an integral part of the project."

X. LIMITATION ON REFINANCING PROVISIONS

SOP 50-22 Chapter 6, Paragraph 26 f(4), page 42.1 of the SOPs, permits:

> "Debt consolidation may be permitted provided that the amount of funds used for such purpose is no more than 10% of the debenture proceeds."

This provision places an artificial limit which does not serve the best interests of the SBA, the SBC, the CDC or the First Mortgage Lender. The Technical Issues Committee is in complete accord with the intent of this provision, but believes the language regarding refinance in the SOP 50-22 dated Setember 1981 is preferable to the existing provision. The Technical Issues Committee recommends reverting back to the September 1981 SOP 50-22 provision regarding refinancing.

XI. LEASABLE SPACE IN NEW CONSTRUCTION

SOP 50-22, Chapter 6, Paragraph 26 (d), page 41, requires:

> "Debenture proceeds may be used for the construction of commercial rental space only under the following conditions: Commercial rental space, up to 15% of the total space is permitted when (a) reasonable projections of growth indicate the SBC will need additional space in the reasonably near future and (b) due to the nature of construction, it is not feasible to build an addition to the building in the future."

This provision, in effect requires the SBC to be at 85% of full capacity on the day on which the new building's doors are opened. This will force the SBC to undergo numerous small expansions which are prohibitively expensive. In addition, the 85% rule appears cumbersome and arbitrary when compared to the 51% rule for acquisitions of existing buildings. Operationally, the program will seem less bureaucratic and the SBC will be allowed to undergo fewer moves and/or expansions if new buildings are subjected to the same rule as existing buildings. The Technical Issues Committee recommends that use of 503 funds be permitted in new construction projects so long as the SBC occupies 51% of the space.

In addition, the 85% rule has been interpreted in the field to mean a prohibition of SBA 503 assistance in projects involving an addition to an existing building in which the SBC has leased more than 15% of the builidng area to third parties. For example, the Denver SBA field offices believe an expansion to a two-story structure whose first floor is occupied by the owner-user SBC and whose second floor is unusable as retail space (and consequently leased out to others) is ineligible for SBA assistance even if 100% of the expansion is to be utilized by the SBC.

XII. ISSUES REGARDING FEES

1. ATTORNEY FEES

There appears to be confusion regarding a potential conflict between SBA Regulations and the SOPs. SBA Auditors have stated in several audits that the Regulations require the CDC attorney's fee to be paid out of the 1½% processing fee. Since the Regulations supercede the SOPs, the auditors are finding the CDCs who pass on the attorney's fee to the SBC to be in violation of the Regulations. This issue needs to be resolved quickly. No CDC can survive if 1/2 to 2/3 of its income is expended for attorneys' fees.

2. 502 FEES

A CDC who packages a 502 loan presently is not permitted to receive similar compensation for providing a service similar to a 503 loan. The Technical Issues Committee urges the SBA to permit a similar fee structure for both 502 and 503 loans.

3. UPFRONT DEPOSIT FEES

Most CDCs require an applicant SBC to make an application deposit (less than the 1½% processing fee) prior to packaging the loan. The deposit is to cover out of pocket expenses incurred in packaging the application and insures that the SBC will not walk from a commitment for financing after the SBA writes an Authorization. Typically if a loan is not approved, the deposit is refunded. Some SBA Field Offices prohibit such deposits which are typical in the private sector. If an SBC walks from a commitment without having to lose its deposit, the CDC will have expended a considerable sum of money to package the loan which will require packaging several more projects to reach break even. The Technical Issues Committee recommends SBA approval of languge permitting an application deposit similar to that found in Exhibit B.

XIII. ISSUES REGARDING CERTIFICATION

1. GEOGRAPHIC AREAS

Some SBA Field Offices are designating minimum geographic areas for a CDC and discouraging the formation of CDCs who have less than a regional base on the theory that at some point in time a Regional or Statewide CDC will be formed. In reality, a CDC should be free to select its own boundaries based upon its priority and ability to service an area.

2. MEMBERSHIP REQUIREMENTS

Some SBA Field Offices are requiring minimum membership which far exceeds the SOPs requirement of 25 members. For example, some Field Offices require one member per county. In large states with many counties (e.g., Georgia) a near Statewide CDC would have a membership in excess of 100. In reality, the CDC should be permitted to determine its own membership selection requirements so long as it meets SOP guidelines (i.e., 25 members).

3. PRIVATE SECTOR LEADERSHIP

Some SBA Field Offices are discouraging private sector lenders leadership in the CDC based upon a notion of conflict of interest. In reality, strong private sector lender leadership will enhance the quality of deals submitted to the SBA.

4. ELECTION OF THE BOARD

SOP 50-22, Paragraph 8(b) requires:

> "The CDC's board of directors and officers must be elected by the membership/stockholders and not appointed to their respective positions".

This provision will prohibit CDCs from being formed with strong public sector leadership. Mayors and Governors who organize CDCs to serve the public interest should be permitted the authority and priviledge to appoint the Board and Officers. Strong CDCs whose leadership depends on public sector support will suffer.

5. CAPITALIZATION

Rumors continue to persist in the field that a CDC may be required to provide its own capitalization. In reality, most successful CDCs exist on shoe-string budgets with no surplus capitalization. Public sector related CDCs cannot raise capital from (say) City Council in excess of the current year's budget because the council cannot encumber tax revenues it has not yet received. Purely private sector CDCs provide the staff by having another entity (e.g. a Chamber of Commerce) cover the staff costs. Requiring capitalization will be the death knell for most successful CDCs.

XIV. FINANCING RELATED ISSUES

1. SINGLE PURPOSE BUILDINGS

SOP 50-22 Chapter 1, Paragraph 2 notes that assistance is not intended for:

> "To finance construction or purchase of buildings designed to be used only for a single purpose."

SBA Field Offices are interpreting this provision in a variety of ways. Some offices believe that any building short of a rectangular, block building suitable only for warehousing is special purpose (e.g., restaurants are considered special purpose in some Districts). The provision ignores the fact that a special use building may have many alternative users in the same building. Many users of "special use" buildings are excellent credit risks and make fine 503 projects. Good credit risks users should not be discriminated against on the basis of collateral risk especially if the likelihood of finding a replacement tenant is high. The Technical Issues Committee recommends that the issue of special use either be deleted or reworded recognizing that special use is a credit decision, not a policy decision.

2. MOTELS AND OFFICE CONDOS

Some SBA offices are prohibiting the use of 503 funds for motels on the grounds that they are excessively high risk. To the contrary, motels can be highly successful businesses and clarification to the field should be made. The SOP 50-22 Chapter 1, Paragraph 2 notes that 503 is not intended for use in office condos where the job impact is insignificant. The Technical Issues Committee supports the intent of the provision but emphasis must be made to permit 503 office condominium financing where the economic impact standard is met. Much of America, especially in urban areas, is becoming service oriented. The latests DOL statistics indicate that for the first time in America's history, jobs in the service sector exceed jobs in the production/manufacturing sector. The service sector needs offices, not factories. Condominium office space typically is the wisest course of investment for a successful small business in much the same way home ownership is the wise course of investment for the American family.

3. TURN DOWN LETTERS

Some SBA Field Offices are not following the SOP 50-22, Chapter 5, Paragraph 19 (page 30 of the SOPs) which requires:

> "Application for financial assistance will not be accepted for processing and no assistance may be extended unless the CDC can demonstrate to the satisfaction of SBA that the desired financing is not available from non-federal sources on reasonable terms. Such evidence shall include a written notification from the first mortgage lender and the SBC's bank of account stating that such financing is not available to the SBC at the interest rate and terms prevalent in that community."

SBA Field Offices require a CDC to obtain two declination letters in addition to the first mortgage lenders commitment letter. Often, the lender must decline the loan on a 7(a) guarantee basis. The Technical Issues Committee recommends that Central Office reemphasize that the intent of 503 is to finance successful businesses who cannot obtain long-term fixed asset financing, not businesses which are unable to obtain credit. The paragraph is sufficient as written; Central Office need only issue a clarification of the requirement.

4. ASSUMPTION OF A 503 LOAN

Nowhere in the SOP is the assumption of an existing 503 loan by an eligible SBC mentioned. With the prepayment penalty provision potentially causing widespread injury, the SOPs should permit an eligible SBC to assume an existing 503 loan should one SBC sell the real estate to another eligible SBC. This provision will make the property more marketable. The Technical Issues Committee recommends the adoption of such a provision.

5. CHANGE IN OWNERSHIP OF SBC

The Authorization and Debenture Guarantee contains the boiler plate language in item 1(e) that:

> "An agreement executed between the SBC being assisted and the CDC, providing that any and all outstanding obligations may be accelerated and payments called for by CDC and SBA if the SBC during the term of this loan effects change in ownership or control of the business without prior written consent of the SBA."

The Technical Issues Committee supports the intent of the provision. We do recommend, however, the following addition, as comfort to the SBCs who are incurring an obligation which will not mature for 15-25 years: "Such prior written consent will not be unreasonably withheld so long as the resulting ownership entities meet the SBA's definition of an SBC and satisfy the SBA's credit requirements."

6. FINANCING BOTH M&E AND REAL ESTATE ASSETS

Confusion in the field exists over what M&E may be included in a 503 project. Some SBA Field Offices permit only M&E which has a life of 15 years or more. Others permit the weighted average life of the assets in projects including both M&E and real estate. The Technical Issues Committee recommends that SOP 50-22, Paragraph 26(e) be expanded to include a single paragraph permitting the use of the weighted average useful life of the assets concept in projects including both M&E and real estate assets. The weighted average useful life of the assets minimally must equal 15 years.

7. EQUITY BUILD-UP IN A BUILIDING

In projects involving renovation to existing buildings already owned by the SBC, the question always arises regarding the use of the equity build-up for the 10% local injection. The SBC, in reality, has invested considerable amount of cash into a project in the process of paying down the existing mortgage. The Technical Issues Committee recommends that a subparagraph be added to SOP 50-22, Paragraph 26(c) permitting the use of equity in an existing builidng as the local injection subject to the following conditions:

1. The equity can cover the 10% injection only. The SBC cannot fund out its equity and receive any refund.

2. The provision applies only to equity in real estate, not equity in various pieces of M&E.

3. The equity build-up will be calculated as follows:

Equity Build-up = Cost of Building - Outstanding Mortage

This definition by using cost rather than appraised value requires actual cash to have been injected.

4. The equity build-up must be supported by the appraisal (i.e., the appraised value must equal or exceed the original cost). To the extent that the appraised value is less than the original cost, the equity build-up will be diminshed, dollar for dollar.

8. PERSONAL NET WORTH IN 502 PROJECTS

Many SBA Field Offices require the principals of the SBC to meet the 7(a) personal net worth restrictions in 502 projects rather than 503 personal net worth restrictions. The Technical Issues Committee recommends the SBA Central Office issue a clarification permitting the 503 personal net worth test to be applied to 502 projects.

9. 10 YEAR BALLOON PAYMENTS

Many SBA Field Offices ignore the provision permitting ballon payment mortgages from regulated first mortgage lenders unless the lender commits to refinance the mortgage at the end of the tenth year. The reality in the market in the Northeast and Midwest is that no lenders (even the so-called long-term lender insurance companies) are providing mortgages in excess of 10 years. The alternative is to require the first mortgage lender to self-amortize the 10 year mortgage which only increases the debt service burden on the SBC and the risk to the SBA during the early project period. By year 10, equity has been built-up in the building, prices of the real estate have probably appreciated, SBC sales will have increased, and the relative burden of the loan on the borrower will have decreased. The risk lies not in the balloon; the risk lies in the excessive debt service if the balloon is not permitted. The Technical Issues Committee requests SBA Central Office to issue a clarifying memo to the field.

10. RATE RESTRICTIONS

Several 503 first mortgage lenders do not use New York Prime as the basis of their rate calculations. The Technical Issues Committee requests the SBA permit alternative definitions of rate calculations including local prime (if published locally) and LIBOR (the London Interbank Rate).

11. FORWARD COMMITMENT

SBA policy discourages 502 guarantees or 503 debentures as forward commitments in projects being constructed by property developers even when the commitments are contingent up on identification of a qualified SBC and the approval of the loan by the SBA. Professional developers of industrial parks can relieve SBCs of much of the risk and expense of purchasing or constructing property. In order to proceed, they need to know that SBA 502/503 financing is available to qualified and credit worthy SBCs. The Technical Issues recommends that SBA policy permit for[illegible] commitments with appropriate contingencies safeguarding the SBA.

XV. ISSUES RELATED TO SERVICING, REPAYMENT AND REPORTING

1. PM SERVICING REQUIREMENTS

SOP 50-22, Chapter 5, Paragraph 20 a(c)(7) requires:

> "The Lender (PM Lender) must demonstrate to the satisfaction of SBA that the loan will be adequately serviced."

The PM lender is not a financial institution and the requirement that it act in a capacity similar to a financial institution is unrealistic. The CDC will have to service the PM projects more closely. The Technical Issues Committee recommends that this restriction be deleted.

2. PREPAYMENT PENALTIES

The potential problems with prepayment penalties are enormous. SBCs who prepay debentures may be forced out of business. The Technical Issues Committee recommends that elimination of the prepayment penalty be investigated. Two possible solutions include: 1) not allowing prepayment discount windfalls (in rising rate environments) to accrue to SBCs and using the discounts to fund out premiums in falling rate environments, 2) allowing SBA to charge a 1% up front fee to be used to establish a prepayment pool from which any prepayment penalties would be paid. The SBC could be permitted to elect to incur the 1% fee in exchange for relief from the prepayment penalty burden.

3. CDC SERVICING REQUIREMENTS

The SBA has no policy concerning the CDC's servicing obligations. The Technical Issues Committee requests to convene with the SBA Central Office to establish reasonable and uniform servicing requirements for CDCs.

4. CDC REPORTING REQUIREMENTS

SOP 50-22, Chapter 2, Paragraph 9(a) (1), (2), (3) (page 17 of the SOPs) require the CDC's Operating Report to include:

- Summaries of meetings in which a change in membership, Articles, and/or By-Laws occur

- The date and location of all CDC Board meetings

- A discussion on actions taken on loan application and proposed projects.

This information is contained in the minutes of the meeting which will be available to the Auditors at all Audits. The Technical Issues Committee recommends that the Audit Review replace the Operating Report requirement.

XVI. MISCELLANEOUS ISSUES

1. PRIVATE SECTOR ADVISORY GROUP

Presently, no one in the SBA 503 Central Office has a Private Sector Advisory Group to work with in thinking through proposed changes and improvements in the 503 program. The Technical Issues Committee recommends that Central Office form an ad-hoc advisory committee consisting of Central Office, SBA Field Offices, NADCO aand others to provide on going dialogue on proposed changes in the SOPs.

2. REGULATIONS VS. SOPS

SBA Auditors make references to conflict between the SOPs and the Code of Federal Regulations. The result is causing much uncertainty in the Field, within both SBA Field Offices and within CDCs. The Technical Issues Committee requests Central Office to review the consistency of the regulations and the SOPs and to make corrections as necessary.

STATEMENT OF ROGER L. PETERMAN, PRESIDENT, COMMONWEALTH SMALL BUSINESS DEVELOPMENT CORP.

Mr. PETERMAN. Senator, I am Roger Peterman, president of the Commonwealth Small Business Development Corp.

I would like to give a little background because I think our CDC is a little bit unusual relative to some of the others, since we operate on a statewide basis. I would also like to give a brief history of what our experience has been. I would also like to address directly some of the aspects of the tax-exempt financing and how I think that would impact on the success of our program.

First of all, as a matter of background, I think it is well known that, under the Governor's direction, Kentucky has taken a strong step toward promoting economic development, and I think a particular focus has been the small business sector.

It was recognized early on in the economic development efforts that financing is one of the greatest needs and one of the greatest problems for the small businessman, particularly when you are talking about expansions, which includes fixed-asset financing. Assets need to be financed over a long term, a longer term than is generally conventionally available.

This has been done through the Kentucky Development Finance Authority, whom I also represent, which is a State-funded program, but the demand for those funds was so substantial that we sought other sources, and the 503 program meshed directly into the type of thing that we were trying to do.

We thought it was important from two aspects. First of all, obviously, it assisted the businessman. I think a second point that often is overlooked is that it encourages banks to make small business loans. It assists the businessman through removing some of the interest rate risks because the loans are at fixed rates. It also allows the small businessman to borrow at corporate rates and finance things over a long term.

Second, I think it encourages the banks because we have seen banks actually lengthen the term of their loan when the 503 program is involved. It also increases the business viability of that business being financed, so again the bankers are encouraged to get involved in the program, and we have also seen rural banks be able to finance larger projects than they would otherwise be able to finance.

We happened to set our program up on a statewide basis so that it would be available in rural areas that would not have enough activity to support a 503 on their own.

So with those objectives in mind, we had our first organizational meeting in September, received certification in December, and in January we had a press conference announcing the program that Senator Huddleston was generous enough to attend to indicate his support, and I would like to point out that that is very important, particularly at a time when there is some uncertainty about programs. I would again like to, for the record, thank the Senator for his public support of this program and the effect that it has had on small business in Kentucky.

Senator D'AMATO. And I think we also should note his cosponsorship of the legislative efforts.

Mr. PETERMAN. Yes, I think that is true.

We have approved 12 loans to date. For example, one of the first ones that was closed was Kentucky Mountain Industries, which is in Manchester, Ky., a rural Appalachian county. They have unemployment in the midteens. This small business started in 1978 as a metalworking machine shop type of business. They had a chance to expand but were not able to obtain long-term financing from their bank, and when the 503 became available, we combined with the local bank in Manchester. Now the company employs 40 people and is the second largest employer in that town at 40 people.

So I think it is these types of businesses that the 503 has been able to help. As I mentioned, we have done 12 projects and have made over $1.5 million in 503 loan commitments for total financing approaching $5 million. This will mean 151 jobs to Kentucky.

Now, this program has been successful in the State, but I think that we are focusing on some things that can make it even more successful. I think the most important revision that could be made would be in this area of allowing the 503 program to be used with tax-exempt financing. We have actually experienced situations where people have not gone ahead with projects because the 503 could not be combined with the IDB's.

The decision to go ahead is obviously based on return relative to risk. If the return is not adequate because of high interest rates, the business is not going to go ahead. I think by bringing in the tax-exempt financing, it increases that return and also reduces the risks that the businessman is facing. I think the clear effect of allowing the 503 to be used with IDB's is not a double subsidy, but I think it just makes the IDB's available to small businessmen that don't have it available to them now. It encourages the bankers—one of our objectives—to get involved with small business loans. So I think that we have to focus on that as being the effect.

I think that as conventional rates go down, it is not going to be necessary to use both of these programs. I think it has a countercyclical effect: When interest rates go up, IDB use will go up. But I think that is the point, that we need to encourage business expansion and business development during these times of high interest rates.

As far as the comments that were made about Treasury's position that if the 503 loan is subordinated to an IDB that it makes a security, that IDB tax-exempt security, superior to any other Treasury security, I think that indicates, I guess, a total misconception or lack of knowledge of the reality of these securities in the marketplace. There would not be any market, any public market, for an IDB that had a 503 subordinated to it. It would be a security that has to be held by that bank. Obviously, it cannot be traded; it is not guaranteed by the Government; and it is going to be something held for the bank's portfolio. I cannot see, by any stretch of the imagination in my experience, that this could be viewed as an obligation superior to an obligation of the U.S. Treasury. I think it is some sort of mental gymnastics that they brainstorm to try to find something to hang their hat for denying use of the 503 program with IDB's.

Apparently, this is why they have come up with this rule allowing the coequal position, because their logic has backed them into that position of having to allow the IDB if it has got a coequal position. But I think there is no question that if they stick to that position, small businesses will still be denied the use of tax-exempt financing. Projects will still be delayed because of high interest rates, or businesses still will not go forward.

I really think that the position of the SBA and the Treasury on this is, in reality, untenable if one takes reality into account. [Laughter.]

I would also like to emphasize the importance of changing the alter-ego rules. I think that Mr. Berman has covered that, and I will not go any further, but I would like to conclude by saying that this program is helping to promote small business expansion, and I think that with the 503 program small business will be able to do its part in leading us out of this recession.

We have seen projects go ahead because of the availability of long-term financing that the 503 program provides. We have actually seen bankers—I would say, in 12 out of 12 loans that we have done, the bankers have lengthened the term of their loan because of the 503 program. This success has been obvious.

I think the most direct way that we can improve the program at this time with some very simple changes in policy is to allow IDB's to be used with the 503 program.

Thank you.

[The prepared statement of Mr. Peterman follows:]

COMMONWEALTH
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STATEMENT BY
MR. ROGER L. PETERMAN, PRESIDENT
KENTUCKY DEVELOPMENT FINANCE AUTHORITY
BEFORE SUBCOMMITTEE ON URBAN AND RURAL ECONOMIC DEVELOPMENT
SENATE SMALL BUSINESS COMMITTEE
SEPTEMBER 28, 1982

TESTIMONY REGARDING THE COMMONWEALTH SMALL BUSINESS DEVELOPMENT CORPORATION BEFORE THE SUBCOMMITTEE ON URBAN AND RURAL ECONOMIC DEVELOPMENT SENATE SMALL BUSINESS COMMITTEE.

BACKGROUND

It goes without saying that small business is the primary focus of Kentucky's economic development efforts. As a person who began his career as a small businessman, Governor John Y. Brown, Jr. has chosen small business as the foundation for renewed economic growth in Kentucky. As an indication of the Governor's commitment to small business he requested that the National Governor's Association form a Small Business Task Force. Governor Brown now chairs that committee. He has testified before Congress on many small business issues as well as initiated many changes in Kentucky law to assist small business.

In addition to these efforts, the Governor recognizes that, today, the most difficult problem facing small business is the cost of financing. This difficulty encompasses the financing of day to day operations. However, the greatest problem caused by the current condition of the credit market is the financing of expansion. Expansion generally requires the financing of land, buildings, machinery and equipment. Fixed assets, with their long economic life, high relative cost and longer return on investment require long-term financing. Unfortunately, because most small businesses are limited to commercial banks for debt financing, the small businessman is unable to obtain the long-term financing he needs to expand and increase employment. Commercial banks are basically short-term lenders and have become more so due to the recent volatility of interest rates. Unlike their large corporate counterparts, small businesses cannot individually access the national credit markets which are currently the only source of long-term fixed rate financing.

Therefore, the Governor through the Kentucky Development Finance Authority has attempted to address this problem directly. In 1980, the Governor introduced legislation that greatly expanded the role of the Authority. The Authority was empowered to lend funds directly to small businesses in participation with bank loans. It soon became apparent that the assumption that financing was a major obstacle to business expansion was correct. The demand for the Authority's funds was substantial - indicating that entrepreneurs were willing to go ahead with a project if reasonable financing could be obtained. Because of the limitations of State funds available to the Authority, a decision was made to form the Commonwealth Small Business Development Corporation (CSBDC) to seek certification as a Small Business Administration 503 lender.

Based on our experience, it was felt that 503 funds would generate a significant amount of small business activity through causing businessmen to go ahead with plans that had been delayed by removing some interest rate risk due to the fixed rate nature of the loans, and by making some projects feasible through allowing small businesses to borrow funds at rates comparable to those enjoyed by large corporations. It was also hoped that banks would lengthen the term of their loan since their percentage loan amount would be lowered with 503 participation. Banks would be additionally encouraged by the removal of a portion of the interest rate risk to their small business borrowers with the fixed rate financing. Also, Kentucky's rural banks would now be able to finance larger projects which would otherwise exceed their loan limits. The encouragement of both the businessman and the banker was seen as a key to expansion.

Additionally, a 503 Corporation was needed on a state-wide basis to serve the rural areas. Kentucky's population distribution is such that many areas of the Commonwealth would not have sufficient loan activity to finance the staff needed to operate a local development corporation. The Commonwealth Small Business Development Corporation was formed, not to replace local development corporations, but to serve areas where local development corporations could not function. It was also felt that the Authority's experience in lending would result in quick certification. Based on the existing plight of the small business borrower it was felt that access to 503 funds should be made available to State residents as soon as possible.

HISTORY OF CSBDC

On September 11, 1981 the first organizational meeting of the CSBDC was held. At the meeting a nine member board was elected and a resolution was adopted to apply to the SBA for certification. Certification was received on December 17, 1981. On January 5, 1982 a statewide press conference was held in the State Capitol to announce the certification and the availability of the 503 Loan Program in Kentucky. Immediately following the press conference the first regular monthly meeting of the CSBDC Board of Directors was held. Three loans were reviewed and approved.

The first 503 loan commitment was to Kentucky Mountain Industries (KMI), a small manufacturer in the Appalachian Kentucky city of Manchester, where unemployment has reached 12.4%. KMI was incorporated in 1978 and began manufacturing with 2 employees. In 1980 KMI grew to support 21 employees. In 1981 the demand for Kentucky Mountain Industries products was exceeding their manufacturing capabilities. Another expansion was planned by management but became virtually impossible because of small town bank loan limits, high interest rates, and the lack of long-term fixed asset financing. Because of the CSBDC 503 Loan Program, Kentucky Mountain Industries was able to proceed with their $120,000 expansion project. This increased commerce to eastern Kentucky by hundreds of thousands of dollars, and 10 new additional full time employees were hired. KMI now employs 40 full time workers, and is Manchester's second largest employer.

A second example of CSBDC activity is the Bowman Kelley Office Systems Corporation project. The company was planning to expand their business and renovate a vacant historic downtown landmark in Bowling Green, Kentucky. Because of high interest rates, lack of long-term fixed rate financing and the inability of Bowling Green banks to finance the total project under terms vital to the cash flow needs of Bowman Kelley, this renovation project and business expansion was on indefinite hold. When the 503 Program became available a loan package was developed with local banks which brough debt service payments to acceptable levels. This project not only created 9 new jobs but the building now serves as a vital anchor to the historic town-square business district in downtown Bowling Green.

In the relatively short period of time the 503 Loan Program has been in effect in Kentucky, substantial results have been achieved despite a poor economy and persistently high interest rates. To date, 12 projects have been approved by the CSBDC Board of Directors with many more from the 120 county state under staff review. New fixed asset investment of $4,768,000 has been generated by $1,546,000 in 503 loan commitments which will create 151 full time jobs within twelve months.

Over 820 letter and telephone inquiries have been received by the CSBDC staff regarding small business loans. Many of our inquiries have not resulted in immediate applications, however, the 503 Loan Program has generated a great deal of interest in planning expansions, now that businessmen are aware of a potential source of fixed rate financing.

Kentucky commercial lending institutions have embraced the concept of the 503 Loan Program and have become the primary originators of loan prospects. In addition, participating commercial banks have been willing to provide longer repayment terms usually 10-15 years - rather than the standard 3-7 year terms. Projects that would not be feasible with conventional bank financing because of cash flow problems created by high debt service requirements, have become feasible because of extended terms. With the 503 Loan Program Kentucky banks are more readily willing to finance small businesses.

It is interesting to note why banks have accepted the program readily. First, the lower fixed interest rate and longer term enhances the businesses feasibility, making the bank a more willing loan participant. Secondly, as in any participating loan situation, the loan risk to a single banker is reduced by apportioning the loan between two or more financial institutions. Finally (and probably most importantly), the bank is required to do very little paperwork for SBA. It has been our experience that some banks have hesitated to use the SBA 7A Guarantee Program due to the paperwork. With loan documentation responsibility falling to the CSBDC, banks can treat the transaction like any private multi-lender transaction.

RECOMMENDED REVISIONS

Today in Kentucky the 503 Program enjoys a solid reputation in the small business and banking communities. Continued success will depend on the quality of certified CDC operations including timely processing by the SBA, continued funding levels, and approval of quality loans. However, revisions of some SBA Standard Operating Procedures and Guidelines may be the most direct method of immediately assisting the CDC's in helping SBA meet the objectives of the program. Based on our experience, two basic changes would significantly enhance the programs viability. Both revisions involve coordinating the 503 Program with certain tax code provisions intended to encourage business investment. Both are discussed separately below.

1. Tax Exempt Financing - SBA is currently taking the position that 503 loans cannot be involved in projects using tax-exempt financing through the issuance of industrial development bonds (IDB's). SBA has taken this position despite regulations allowing the combination of 503-IDB and despite a conference committee report indicating congressional support for combining the programs.
   Due to SBA's position on this matter we have actually experienced situations where businesses put off expansion plans. In undertaking a capitol

expenditure program, a businessman will calculate his return on investment relative to the risk involved in achieving that return. If the return relative to the risk is adequate then the investment will be made. The 503 Program partially deals with both factors in that equation. First, it marginally lowers interest rates to those competitive with large corporations, increasing the return on investment. Secondly, it reduces the risk of interest rate fluctuations by providing a fixed rate. Unfortunately, in many small business situations, the business by reason if its small size must be so, risk averse that the 40% 503 loan does not raise the return or lower the risk adequately. Small businessmen have presented loan proposals in which they require a 13%-14% interest rate. The 503 Program can meet this requirement - but not in combination with conventional financing. When the floating rate feature of the bank loan is added, thus increasing the risk, expansion plans have been shelved.

Combining the program with IDB's could solve this return-risk problem during this period of high interest rates. The return to the businessman would be enhanced by the lower interest rate. The significant interest rate savings comes from the IDB's themselves. Although the 503 rates are marginally lower than conventional (i.e. corporate bond) rates, the clear effect of the 503 would be to make IDB financing available to certain small businesses who would otherwise be denied. The risk of floating rates would also be reduced since the potential increase in tax-exempt rates would only be a percentage of the increase in conventional rates. Additionally, a fixed rate may be possible since the fixed rate at which the bank will lend will be lower if the loan is tax exempt - possibly low enough to be acceptable to the borrower. As conventional rates go lower, the problem will solve itself. In fact, tax exempt financing will become unattractive due to the additional expense of using IDB's. However, the purpose of the 503 Program - to help today's small businessman expand and help turn around the economy - is clearly stifled by restricting 503-IDB combinations.

Many agreements have been made for and against the use of IDB's. By its latest tax action, Congress has again recognized the effectiveness of IDB's in promoting business investment. SBA's position is inconsistent with that of Congress when it denies the use of IDB's to the very businesses IDB's are intended to benefit. The success of Urban Development Action Grants are an indication of how IDB financing can enhance the success of a federal program. It has been our experience that 503-IDB combinations would have the same result.

2. The "Alter-Ego" Restrictions - The current S.O.P.'s regarding business ownership require that the owner of the assets be identified to the owner and user of the business. These restrictions have created significant problems for certain businesses in qualifying for the program. Due to recent tax revisions undertaken to encourage capital investment, it is often more beneficial to own assets personally and lease them to the business. In certain family situations, for example where the parents propose to own and lease the building, but give an ownership interest in the business to their son or daughter, the building could not be financed with 503 funds. Another common example is where the owner owns a building personally but wants to give certain employees an ownership interest in

the company. Again the building could not be financed with 503 funds. Since the 503 loan is the key to these projects, either the project is shelved or the son, daughter or employees cannot have an ownership interest in the business. These situations are very common to small businesses owning fixed assets and the S.O.P.'s governing the "alter-ego" situation should be modified to accommodate the transactions.

CONCLUSION

The experience of the Commonwealth Small Business Development Corporation as an SBA certified lender over the past six months has been quite successful. The strategy of the Reagan Administration's current economic policy is to encourage expanded production capacity in the business section. The 503 Program has allowed Kentucky small businesses to become active participants in that strategy. We have seen business expansions that were delayed due to the unavailability of fixed rate long-term financing, go ahead when 503 fund became available. We have seen banks lengthen the terms of their loans when CSBDC became a participant in the loan package. We have seen Kentucky's rural banks finance projects that would have exceeded their lending limits without CSBDC participation. This has been accomplished within a very short time frame and the program has been utilized by borrowers covering almost the entire state. By allowing the program to be used with IDB's and by revising the alter-ego rules, the program will achieve even greater success. The Commonwealth Small Bsuiness Development Corporation in conjunction with the SBA is playing a vital role in stabilizing and expanding Kentucky's economy on the firm foundation that small business development provides.

C S B D C
LOANS APPROVED

COMPANY	TYPE	CITY	COUNTY	$ 503	KDFA	PRIVATE LENDER	EQUITY	$ TOTAL	JOBS CREATED	STATUS
K.M.I.	MANUFACTURING	MANCHESTER	JACKSON	50,000	29,000	29,000	12,000	120,000	10	Closed
ELECTRICAL CIRCUITS	MANUFACTURING	SHELBYVILLE	SHELBY	136,000	80,000	84,000	33,000	333,000	16	Closed
CAPITAL ALUMINUM	MANUFACTURING	BOWLING GREEN	WARREN	40,000	35,000		35,000	110,000	10	Closed
RADAC	MANUFACTURING	NEWPORT	CAMPBELL	190,000	118,750	118,750	47,500	465,000	20	To be Closed 10/82
MCCAMMISH	MANUFACTURING	WINCHESTER	CLARK	50,000	250,000	250,000	125,000	675,000	9	Pending
DAYS INN	MOTEL	PADUCAH	MCCRACKEN	160,000		200,000	40,000	400,000	7	SBA Ap-proved
LEE FORD MARINA	MARINA	SOMMERSET	PULASKI	104,000		130,000	26,000	260,000	8	SBA Ap-proved
BOWMAN KELLEY	OFFICE SUPPLY	BOWLING GREEN	WARREN	290,000		300,000		725,000	9	Awaiting Curren Financial Statement
MADISON THEATRE	MOVIE THEATRE	COVINGTON	CAMPBELL	50,000		54,000	25,000	134,000	9	In Process
PEARCE MOTORS	AUTOMOBILE DEALERSHIP	SHELBYVILLE	SHELBY	140,000		140,000	70,000	350,000	25	In Process
RED CARPET INN	MOTEL	MADISONVILLE	HOPKINS	280,000		350,000	79,000	709,000	25	In Process
SULPHUR SPRING STONE	QUARRY PRODUCTION	HARTFORD	OHIO	56,000		70,000	14,000	140,000	3	In Process

TOTAL DOLLARS COMMITTED 503	$1,546,000
TOTAL PROJECTED DOLLARS	4,768,000
TOTAL JOBS	151
503 DOLLARS LOANED PER JOB CREATED	10,238

APPENDIX B

ECONOMIC DEVELOPMENT BACKGROUND -- ROGER PETERMAN

In 1978, while still attending law school, I began work for the Kentucky Development Finance Authority. Upon graduation I went to work for the Authority full time as Assistant Director and later as Executive Director. During this time I have been involved in revising KDFA's lending policies, investigating and implementing new programs, and initiating new financial assistance programs -- all devised to increase economic development in the Commonwealth. In 1980 I drafted legislation, which was passed by the 1980 General Assembly. This legislation considerably broadened KDFA's authority, allowing us to implement innovative new programs designed to improve Kentucky's economic development activity. The programs have been highly successful. For example -- in FY 1980/81 KDFA made 15 direct loans, in comparison with only 2 direct loans for the year and a half prior to implementation of the new policies. These 15 loans involved a KDFA commitment of $2,323,500 of a total financing package of $85,403,528 -- creating 571 job opportunities for the citizens of the Commonwealth. In addition to the direct loan activity, KDFA agreed to issue industrial revenue bonds for 3 projects totaling $47,900,000 for another 186 jobs and guaranteed a bond issue for $1,500,000 of the total $3,450,000 financial package for another 100 jobs. (A total of 857 jobs for FY 80.81.)

Senator D'AMATO. Thank you very much.

Senator Huddleston, do you have any questions?

Senator HUDDLESTON. Mr. Chairman, first of all, let me concur in what Roger Peterman has said. I feel that in Kentucky we are fortunate in having an administration that believes that a lot of the problems of the State and a lot of the problems of the State government can be solved, or at least mitigated, by aggressive business promotion.

Our State seized upon this new program as an opportunity to help further that goal, and they are doing an excellent job in making this program available within the restrictions that have been placed upon it.

We as a committee are particularly interested in what these gentlemen have to say, because it is not what a program sounds like when we are debating it on the Senate floor; it is what really happens out there at the local level when that program is implemented or when attempts are made to implement it. Sometimes there is a vast difference in the two.

So our obligation, I think, that by looking at this program in the early stages, we have an opportunity to make some midcourse corrections, or whatever needs to be done to make sure it is effective and that the intent of Congress is being carried out.

I find all of their suggestions to be very interesting, particularly the comments they have made relative to some of the assertions that have been made by the members of the Treasury and the Small Business Administration. That is so important to us because if we get those kinds of comments in a vacuum without finding out what those who implement them feel about them, sometimes we are led down the wrong path. So this is very helpful to us.

Let me ask now, we have dealt with a couple of major problems, the IDB's and alter-ego. We want to give very serious consideration to both of those issues. Are there any other specific handicaps or impediments that you see within the law itself and the interpretations of the law that are being applied by SBA, that we should address that would facilitate the implementation of the program at the local level?

Mr. Gurian.

Mr. GURIAN. Yes, Senator. One of the major problems that we find at the moment is dealing with the Federal Finance Bank as purchaser of the debenture. The procedure is inflexibile. I would like to cite that in February of this year, the rate was 1 point lower than the rate in March of this year. We have a double closing as a result of strict adherence with the regulations. Double closing means that approximately 15 days prior to the auction date, we must irrevocably close the loan.

As a consequence, since the loan was closed in February, the small businessman anticipated a rate of 14. He ended up with a rate—and could not do anything about it; he was locked in—of 15 percent. Difficulties are created that discourage use. Inflexibility, plus the fact that there are severe prepayment penalty clauses—another business had a loan that was on the books about 3 months and, because of business considerations, the loan had to be repayed to the Federal Finance Bank. The prepayment penalty exceeded $22,000 on a $132,000 loan. That is heavy penalty.

Now, we would like to suggest that we be permitted to sell a block debenture, warehouse it, and use it as each project comes up—particularly if one follows my suggestion of a preferred lender status—in which case we would know exactly what the rate will be at time of comittment.

I would also like to suggest that the private sector could consider buying the debenture, perhaps at a rate equal to, the F.F.B. Fluctuations of rate that we are having in these times may permit this.

I want to add just one comment. I really want to thank Senator D'Amato. His position with regard to not only the 503 program, but also retention of the IDA bond He has been a steadfast friend and a sponsor of our Long Island development corporation. In the two counties of Nassau and Suffolk that we serve, we are enjoying at this moment less than a 6-percent unemployment record, which is one-third of what the Federal Government has, or throughout the country, certainly much less than the rest of the State. We have a very, very active program for economic development, and I truly want to publicly express our thanks and support to you, Senator, in this behalf.

Mr. BERMAN. Senator Huddleston, in response to your question, I have two comments, one specific and one general. One point that we have raised in our list of recommendations is the clarification of the in anticipation of SOP of the SBA.

Right now, there seems to be a gap between what the SBA requires and how the requirement is implemented. The SBA has said that they will allow the proceeds from the sale of 503 debentures to repay funds that have already been expended by a small businessman for a portion of his project in anticipation of the future filing of a 503 application. As we know, small business people will expend money prior to packaging the loan because it is in the best interests of the business to acquire property when it becomes available. According to the SOP's this SBC is permitted to expend that money if that small business person and CDC have received a prior authorization for that prior expenditure.

The problem is that there is no process by which the SBA issues this prior authorization. They have only an SBA authorization letter that comes out at the end of a package.

What we have done in Chicago with our cooperative SBA district office, is to write a letter to the SBA notifying them of our intention to work with the SBC in the future and his intention to prior invest in a project. If we hear nothing further from the SBA regarding that letter, we assume that it is permissable for the SBC to proceed with his prior expenditure. He then in fact goes ahead with his expenditure, and we incorporate that into the future package. Our SBA district office has been accepting it.

I think we are rare in having that type of cooperation with our SBA local office; many SBA district offices will not accept that type of letter. We would like to see that clarified because there is no way for a man to properly anticipate his package otherwise.

Senator HUDDLESTON. And that also brings up a point that was made earlier about the inconsistent interpretation by SBA in the various offices of various requirements. Is this a problem, as you see it?

Mr. **Berman**. Yes, it is. That was the general comment that I was getting to. Not only inconsistencies and ambiguities between the regulations and the SOP's but from one office to the other. There has to be some central body to adjudicate these conflicts, and right now that is being done at central office. Every time you need an adjudication on any one of these points, it takes the SBA an additional 4 to 6 weeks, over and above the 6 to 8 weeks now to issue authorization. Our SBC's just cannot wait 4 and 5 months, as has been the case in recent cases.

A simple thing that we posit toward resolving that, as I said before, is the giving of more credit decisionmaking power to the certified development company. The SBA has certified us; they continually review our status. As Mr. Gurian said earlier, he has many capable people on his board, as we all do—bankers, political representatives, lending officers who know both their community and know the credit decisions that have to be made. Once made by us, there is no need for another 6- to 8-week review by the SBA.

Senator **D'Amato**. As a practical matter, I don't believe the Congress nor the SBA will have the authority to give the CDC the kind of lending authority that maybe they would like. I think the answer is somewhere in between. After you have approved, the length of time which it takes the regional office to review your request should be cut. I think there are a number of things on which you have put your finger. You talk about an outstanding representative in Chicago, but he is only one, and here he is servicing all of these applications, and by the very nature of it, he certainly is going to be backlogged.

So it seems to me that what we are really talking about is seeing that the time gap, 6 to 8 to 10 to 12 weeks, be cut to a realistic period of time. Let's say that the application should be reviewed, et cetera, within no more than 30 days, and maybe we will have to require, put some report language in, as a vehicle by which to get a quicker response.

Now, we cannot say 2 weeks because, you know, you recognize and realize that that is not reasonable, but I think that maybe the committee staff could come up with what they think——.

Senator **Huddleston**. You know, in some programs, we have a situation where if you submit something and there is no reaction within a certain period of time, you assume that you may go ahead. The problem is, in some cases, some of the agencies just automatically put a hold on it to give them more time to review it, so you do not accomplish too much in that procedure.

But I think you are getting at what really needs to be done. We need to have a specified time that we can expect to get either a turndown or approval.

Mr. **Berman**. We would greatly appreciate that, Senator, but there is one thing I would like to say in response to your comment about the CDC's and their certification as certified lenders. Right now, the SBA has granted that certification to certain financial institutions, and it is the officers and loan officers of those financial institutions that are on the boards of our CDC's. So the SBA has already certified those very lenders and lending officers to make loans with only minor oversight by the SBA once a loan is approved by the bank, but when that same lending officer is making the credit decision within our CDC, then the SBA must re-review everything he does twice and three times. That is what takes the time.

I think there is that precedent, Senator, for a similar certification process for some CDC's; sort of preferential treatment. I might have some problems with that because I hate to differentiate one CDC from another. I think once they are certified——

Senator D'AMATO. We understand the political realities. Some CDC's, unfortunately, may not run nearly at the type of professional level that yours does over the years. We have always had problems with some projects or loans which are made and then often cited as failures.

So I think we have got to deal with the real world. The idea is how do we see to it that the flow that comes from, if you want to call it preferred CDC's, is expected. I don't know how you draft that. Everyone is going to say——

Senator HUDDLESTON. Maybe we have to rate them.

Senator D'AMATO. Maybe. Maybe that is something that is possible.

Mr. BERMAN. We would very much like to be held up to that scrutiny; to the scrutiny of being a certified lender able to make those decisions without that double and triple re-review by SBA.

Mr. GURIAN. Senator, there is precedence. The SBA at the present time has two banks in varying sectors of the country who are on pilot programs known as preferred lender status, where they just notify SBA that they have taken an action, and SBA merely oversights that action. These are with well-qualified, well-seasoned organizations.

As you probably know, I am president of the Money Store, and we have just received our certification as a certified lender, which gives us some responsibility but also some authority to take on some of these actions.

Senator HUDDLESTON. Does Mr. Peterman have any suggestions now, anything beyond what we have talked about, as to what might help that program?

Mr. PETERMAN. No; I do not think I want to go into any further ones at this time because I think the focus of this hearing was correct that the issue was tax-exempts and also the alter-ego, which is another tax problem, so I think the testimony today has been sufficient.

Senator HUDDLESTON. Let me ask just one more question. These suggestions that you fellows have, have you submitted those to SBA?

Mr. BERMAN. Yes. NADCO, as you probably know, Senators, is made up of 70-plus CDC's in the country, the most active and the most sophisticated of CDC's. We have a Technical Issues Committee which has put together these recommendations plus many more and submitted them to the SBA and Senate committee staff so that we could all sit down and discuss them in detail.

Senator D'AMATO. You sent them here, too?

Mr. BERMAN. Yes; we did. In fact, they are attached to my testimony.

Senator HUDDLESTON. Have you had any reaction from the agency?

Mr. **Berman**. We have been discussing them ever since we put this report together in June. Generally, their response has been favorable. They have said that yes, those are problems and ambiguities and inconsistencies that lie in the program, and they are working on them with us. We have another meeting with Mr. Sanders and his people in 2 weeks and hope to clarify more of these.

But I must say that, since June, not 1 of them has been changed, not 1 of the 36 recommendations.

Senator D'**Amato**. Well, you've got a good hometown boy who will be working on that, the old clam digger from Long Island. You can team up. Senator Weicker has got a couple of problems to dispose of, but when he gets through with those, we will get him going on this, and he loves to chew on these things.

Let me ask you something. We hear all this about how good we are doing, and I see that Long Island we have made 13 loans, total project cost $7,657,000, amount of debentures $2,831,000. Are all those 13 projects still doing fine? Are they operating?

Mr. **Gurian**. Oh, yes.

Senator D'**Amato**. Has anybody defaulted?

Mr. **Gurian**. No.

Senator D'**Amato**. Does everybody look good?

Mr. **Gurian**. Everybody looks good. We don't allow otherwise. [Laughter.]

Senator D'**Amato**. You don't allow it? Your Money Store gets in there and supplements?

Mr. **Gurian**. Well, sometimes. In any case we just don't allow it.

Mr. **Berman**. Let me say, Senator, that I will second that.

Senator D'**Amato**. I mean, that is not a bad question, is it?

Mr. **Berman**. No. no.

Mr. **Gurian**. No, it is an excellent question.

Mr. **Berman**. And from Chicago I would say the same thing. Our default rate is extremely low. In not allowing it, Mr. Gurian is right. We are in the community. We have close touch with the SBC's. We are not a distant loan officer or even a distant bank. We know these people personally. We have reviewed them so many times on a personal, not to mention credit, level that we would not allow them to go broke. We would have to somehow find refinancing for them if any problem arose. Thus far, we have made our decisions so well up front that we have not had to refinance any of them. Problems just have not occurred. These are businesses on the upswing.

Senator D'**Amato**. Has that been your same experience, Mr. Peterman?

Mr. **Peterman**. Yes, I could echo that. I think one of the reasons for that is the way the program is set up. I think it was set up to really finance—the businesses that are going to be eligible for it are businesses that really have a higher degree of success probability, so I think the concept was good, and I think we are seeing the result of that. But we don't have any defaults or any problems.

Mr. **Berman**. There is one more comment that I would like to make, Senator D'Amato. This 503 program is not just a job creation or retention program; it is a community improvement program. So a business going under, under this program, is not just one more closed business and loss of jobs and a blackmark on the program, but to us it is an empty space on our street or an empty space in our industrial park, and that is very bad for our neighborhood. It is something that we are always trying to avoid, and that is why we are only going to make these loans to businesses that are not only eligible and qualified but will enhance the economic climate of our community.

Senator D'AMATO. I think that is important because I have, as a local supervisor and as a Senator, participated in and seen projects which used Federal funds, well intentioned, that deal with a blighted area, UDAG program, and have seen it go the other way, whether it is economics, whether it is due to those kinds of things that are beyond their control, good, tough business management. We have to understand that is one of the things that is a measure of your accountability.

Mr. BERMAN. Yes.

Senator D'AMATO. Your performance, I understand, nationwide has been excellent. It is the kind of thing that maybe will lead to relaxation of some of those curbs that are not necessary and are counterproductive.

I have no further questions.

Senator HUDDLESTON. I have none.

Senator D'AMATO. We thank you very, very much for coming in and giving us your time. Keep up the good work.

Our last panel, but by no means the least, will be Mr. Donald Gallagher, vice president of Chemical Bank, and James D'Addario, vice president of the D'Addario Co., East Farmingdale.

Senator HUDDLESTON. Mr. Chairman, before these witnesses begin, I ask unanimous consent that statements by Senator Dixon, who is ranking minority member of the subcommittee, and Senator Nunn be placed in the record.

Senator D'AMATO. It is so ordered.

[The prepared statements of Senators Dixon and Nunn follow:]

STATEMENT OF HON. ALAN J. DIXON, A U.S. SENATOR FROM THE STATE OF ILLINOIS

Mr. Chairman, today the Subcommittee on Urban and Rural Economic Development, on which I am pleased to serve as the ranking member, opens oversight hearings on the Small Business Administration's so-called 503 certified development company program.

This program was already enacted when I came to this Senate. However, during the past 18 months, I have seen it grow by leaps and bounds in both the urban and rural parts of my State, and the Nation. This program has become an important tool in job creation and business growth. It has provided a means for the small business community, local governments, and the Federal agencies, to participate in a joint program to revitalize our Nation's economic infrastructure—the small business sector.

Mr. Chairman, I am particularly pleased at the aggressive use the people of Chicago have made of this program. I believe there are at least eight certified development companies already in the metropolitan area. While they have targeted areas in which they specialize, they work together in principal and in fact to improve the opportunities for growth and employment for the entire Chicago small business community.

Testifying at today's hearing will be one of the Nation's "experts" in the day-to-day field operation of the 503 program, from Chicago, Ill., Mr. Scott Berman of the Lawrence Avenue Development Co. In addition to his role in the Lawrence Avenue program, Mr. Berman also serves as chairman of the technical issues committee of the National Association of Development Companies [NADCO].

Mr. Chairman, the success of the program to date is a tribute to the ranking Democratic member of the committee, the distinguished Senator from Georgia, Sam Nunn. It was through his initiative, later coupled with the cooperation and assistance of the now chairman of this committee, Senator Weicker, that this program was put in place. We now begin the next critical phase—insuring that the program is on a sound funding and structural footing. If there are operational areas that need to be addressed, we should get them out on the table for discussion, and hopefully early resolution. The Congress, the executive branch, and the development companies share an interest and a responsibility in providing assistance to the small business community. I intend to personally assist in every way possible to insure that that goal is met.

Thank you, Mr. Chairman.

STATEMENT OF HON. SAM NUNN, A U.S. SENATOR FROM THE STATE OF GEORGIA

Mr. Chairman, today the Senate Small Business Committee begins oversight hearings on the Small Business Administration's section 503 certified development company program. I was pleased to join with Senator Weicker in 1977 and 1978 to develop this program within this Committee, to see it enacted, and to know that it is off to such an excellant start in so many communties in this country.

The premises behind the program are rather simple. First, no one knows the needs of a particular community better than the businessmen and women who live and work there. Secondly, while many businesses could use external assistance, for that assistance to be most cost-effective it should be provided as part of a larger plan to enhance both the general community as well as the individual business. Finally, while the Federal Government can and does have a valuable role to play in providing financial and other assistance to the small business community, it ought to do so wherever possible in cooperation with the community-based, financial institutions.

The 503 program provides long-term, fixed asset financings for small businesses that frequently would otherwise not be able to expand, or create new jobs because of the interest rates or the lack of private sector financing. The local and Federal partnership that this program makes available has been shown to provide a viable, affordable, and successful alternative to these businesses.

Most importantly, this program creates jobs—permanent, productive jobs in the local business community. According to SBA's own recent program review, the 503 program has been directly responsible for the creation or retention of almost 14,000 jobs since the program was enacted 26 months ago.

Two months ago, I had the honor of participating in the ribbon-cutting ceremony marking the "closing" of the first SBA 503 debenture approved in the State of Georgia. Under the leadership of Mayor Jackson of the city of Columbus, Ga., and the Columbus Local Development Corp., a moving and storage company was able to obtain financing for a warehouse; financing that was previously unavailable and financing that was four points below the local commercial financing rate. In addition, that financing directly provided 10 new jobs with the company.

Mr. Chairman, I believe the Small Business Administration shares my commitment to this very valuable program. In the past, there were a number of internal central office problems with the certification process. I believe most of those have been corrected. I am aware of a number of issues that have been raised by the agency, and by the 503 companies. Many are technical, and should be dealt with internally. Others, such as the appropriate use of tax-exempt financing for the non-Federal portion of the development company's financing, will probably require a clear decision by the Congress.

Mr. Chairman, since this program began in development in 1977, I recognized that it has the potential of being an excellent economic development tool that can be used easily by both our major metropolitan areas and the rural communities. But I have advocated a deliberate, and planned growth for this program to insure that the controls are in place to adequately protect the legitimate interests of the small business being assisted, the certified development company, and the Government. We are dealing with a unique financial tool, and complicated relationships. As the primary author of this program, I want to provide sufficient guidance to the program directors and participants to make the Congressional purposes clear. In addition, I believe Congress bears the responsibility for providing a stable, and sufficient funding source. The Small Business Administration must implement this program in good faith, fairly and consistently, and take into account in its program management that its purpose is to meet the needs of local communities and local situations as determined by local authorities. The program was never designed to be a straight jacket into which we tried to force local economic development. There is a need for the agency to insure that adequate program controls are in place, and to be receptive, and expeditious, in responding to legitimate issues raised by the people who are in the field trying to assist their small businesses. Finally the economic development community, the small business entrepeneur and other program proponents have a responsibility to cooperate in the implementation of this program, to recognize the essential needs for verification and record keeping, and the need for some degree of uniformity to aid in administering this program on a nationwide-basis and providing an opportunity for agency and Congressional oversight.

Mr. Chairman, in these times of economic difficulty, high interest rates, growing business failures, and record unemployment, the Small Business Administration's 503 certified development company program holds out the promise of a lifeline for economic growth and job creation. But it is a program that must be nurtured, and monitored, and brought along at a deliberate pace if it is to have the success that those of us who participated in its development expect.

As the ranking Democratic member on this Committee, I intend to carefully monitor this program to insure that it fulfills those expectations.

Senator D'AMATO. I will ask the same, that Senator Weicker's statement be placed in the record as if read in its entirety. Without objection, it is so ordered.

[The prepared statement of Senator Weicker follows:]

STATEMENT OF HON. LOWELL WEICKER, JR., A U.S. SENATOR FROM THE STATE OF CONNECTICUT, AND CHAIRMAN, SENATE SMALL BUSINESS COMMITTEE

This hearing has been convened today to review the SBA's section 503 certified development company program. I want to commend my colleague Senator D'Amato, chairman of the Subcommittee on Rural and Economomic Development, for chairing this very timely hearing. With the intolerably high national unemployment rate, and high interest rates continuing to drive businesses under, it is important that Government begin to explore ways to relieve these critical problems. I believe programs such as the 503 program have to be a part of the solution.

Enacted on July 2, 1980, as a part of Public Law 96-302, the section 503 program was designed to forge a partnership between the public and private sectors to fill the need of small businesses for long-term capital at reasonable rates. By authorizing SBA to guarantee debentures for up to 50 percent of a project's cost, the program seeks to leverage that guarantee to encourage private sector lenders to finance the remaining 50 percent of the project.

In 1979, when Senator Nunn and I introduced legislation to create the section 503 authority, I saw it as a vehicle for addressing the traditional problems faced by our Nation's small businesses in acquiring long-term capital on reasonable terms. Equally as important as narrowing the small business capital gap is the program's enormous potential to retain and create jobs in urban centers and elsewhere. With 10 million Americans out of work, certainly that need is as important today as ever.

We should all remember that there is no point in urban renewal if it is not matched by human renewal. People who feel they have no stake in their community will take no part in maintaining it. A job provides the urban inhabitant with a sense of purpose and sense of dignity.

We have all heard that small businesses are a major source of employment for our economy. Studies have shown that over 65 percent of all new jobs in the private sector are created by small businesses and more than 50 percent of our work force is employed by small business. By providing this important source of financing, I believe the 503 program offers business a real incentive to expand and create new jobs and opportunities.

The potential we saw in the program has in part been borne out by the number of companies which have sought certification for the program over the past 25 months. Already, 240 companies have been approved by SBA to issue debentures. According to latest figures, over 200 projects have been completed. At an average cost of around $4,500 per job, over 19,000 jobs have been retained or created. Truly this is the kind of program that we must duplicate throughout the Government to encourage real lasting jobs in the private sector.

Today we will hear from SBA Administrator Sanders and other who have worked in the field with the program about the benefits of 503. As chairman of the Appropriation Subcommittee on State, Justice, Commerce, Judiciary, and Related Agencies, I have been and shall remain committed to ensuring that adequate funding is available to meet the demand. Over the past 2 fiscal years, Congress has appropriated $250 million of funds for this program. Yet, through the end of July, only about $70 million of the appropriated funds had been used. While I can and do appreciate the cautious and prudent manner in which the administration has implemented this authority, I am also concerned that a very productive program not be unduly bridled. I am particularly interested in today's witnesses' thoughts on how we can better promote the program. The SBA has a unique opportunity to play a signficant role in local economic development. Hopefully, this hearing will point out ways to ensure that that opportunity is realized.

Senator D'AMATO. Please go ahead, Mr. Gallagher.

STATEMENT OF DONALD GALLAGHER, VICE PRESIDENT, CHEMICAL BANK, MELVILLE, N.Y.

Mr. GALLAGHER. Good morning, Senator.

Senator, what I would like to do is give you some general comments of our thoughts on the 503 program, which will only take a couple of minutes, and then discuss some of Mr. Mehle's arguments. Without studying it too much, I have come up with 5 or 6 objections, and I am sure if you studied it you would come up with 40 or 50.

In any event, my name is Donald Gallagher.

Senator D'AMATO. I take it you don't think his suggestions are going to——

Mr. GALLAGHER. Well, I think it is a smokescreen.

I am vice president of Chemical Bank and responsible for industrial and commercial and economic development. We are heavily involved in the financing of commercial and industrial properties in our market area and deal with companies expanding, companies who are creating new job opportunities. I have been responsible for economic development on Long Island for the last 12 years.

The question of how to finance a given project today is a constant challenge. At Chemical, we have been the purchaser of numerous industrial revenue bonds for the last few years, but as Mr. Gurian said, these basically have been for companies showing very strong financial statements.

On the other side of that coin is the smaller, solid business, which is really the backbone of our area, which creates the new job opportunities, the types of companies for whom a lender would not purchase 100 percent of a bond issue, but a company for whom a lender may consider purchasing a portion of the bond, say 50 percent. This is fine, but how do we accomplish the balance of the financing?

The question of using the 503 program behind an IRB or JDA—in our State JDA is the Job Development Authority and also tax-exempt moneys—has been discussed in all areas. We question the argument that to combine an IRB with an SBA 503 should be referred to as double dipping. There have been reports made in our area which show that the use of IRB's produced tax revenues to various governmental agencies far in excess of the loss caused by the tax-exempt feature of the IRB.

The argument of double dipping becomes weaker when we consider the broader issue of creating jobs and bringing the unemployment rate down. In recent years, when the prime rate did not fluctuate as it does at present, and the thrift industry was healthy, it was relatively easy to finance an industrial project. The main lending area of the thrift institutions was long-term mortages at fixed rates, usually for a period of 20 years. If the project location was suitable and the company was creditworthy, a deal could be made. Today the thrift industry has very little in the way of mortgage money available, and whatever money there is, there is tremendous demand for it. The typical financing was a 50-percent first mortgage and a 40-percent second mortgage from the State Job Development Authority.

Today we need every tool at our disposal to finance an industrial project. An industrial project to me means a factory. Surely companies who can afford to expand in this economy must find the proper financing tools to fund the building and land purchases on a long-term basis as reasonably as possible. The overheads in companies today are extremely high, and the cost of building and land financing must be kept to a minimum. The pressure on working capital and cash flow is crucial to the success of a small business.

I personally would rather see a company avail itself of 90 or 100 percent financing on building and land and equipment and retain its cash for use in the daily operation of the business or for research and development.

Let us take, for example, a 30,000-square-foot building at a cost of $1 million. The thrift institution may no longer take a 50-percent mortgage due to a smaller allocation of mortgage money, but they may take a 40-percent mortgage of $400,000. We may then ask the State to lend 40 percent in a second mortgage position. We should be able to turn to the SBA 503 for the remaining 10 percent, but since the State is involved in tax-exempt financing, we cannot use the 503 program.

The company now is expected to invest $200,000 rather than $100,000, in addition to moving expenses and all other costs inherent to a relocation. Or, in this example, if my bank were to take a 50-percent position in the form of an industrial revenue bond and the company did not qualify for the State program, we should be able to turn to the 503 for a $400,000 second mortgage, but we cannot due to the tax-exempt in front of the 503.

A company utilizing this size facility may create 40 or 50 new job opportunities over the next 2 years, and this to me represents the real question, and if we are to consider the amount of money that may be allocated to the 503 program, $250 million, overall this represents a small investment on the part of the Federal Government to create the thousands of new job opportunities which in turn create millions of dollars in tax revenue. We must create job opportunities, and we can, but just as things change around us, so must the tools that we need to build factories change.

In my opinion, the SBA 503 program should be able to be used with any type of financing that is available, tax-exempt for otherwise. We should be looking for ways to make the financing easier, again to create employment.

I personally would like to see the SBA lending authority raised to $750 million or $1 million, but that is a separate issue.

We hear the argument that Government should not be used in this type of financing at all, but by the private sector entirely. In the past, that point could be argued for some time, but in today's market, Government financing is imperative if we are to build factories and research and development facilities.

I would also like to point out that in dealing with small businesses, for every loan that is processed, three or four may be turned down. The point here is that when we get involved in a project, we are serious about it. I hope nobody in Treasury or wherever feels that this is any kind of giveaway program.

Once an agency takes on a project, we spend a lot of time and effort to see that the project comes to full maturity. We are making loans to the backbone of what this country is all about, the solid small business.

My thoughts on what Mr. Mehle had to say are several. First of all, you have to remember that insurance companies are also purchasers of industrial revenue bonds. I cannot speak for the insurance industry in general, but I know that if you were to walk in and say to them, we want you to buy a bond issue and the Government is going to be in an equal position, they would laugh you out of the room. I mean, they are there to make first mortgages; they are investing their money. They will not share that position with anyone.

The other thing that comes to mind is that the legal fees on an industrial revenue bond are high, and we are fighting that where we can in our area, but if you were to combine a pari passu position, or a coequal position, I shudder to think what those legal fees would amount to if you had to have attorneys reviewing that type of situation.

Also, as you know, Senator, in our area we use the JDA with the 502, and we would like to use it with the 503. The State is in a second mortgage position. They are certainly not going to stand still and let the 503 program be in an equal position with the first lender. So there again, it creates a lot of problems.

I think that this whole thing would be confusing because I meet with small businessmen on a daily basis, and the minute you mention SBA—because, in my opinion, SBA still suffers from a PR standpoint—the principal of the company cringes. What comes to mind is that the house goes up, the wife, the kids, certain parts of his body, and that is what it is perceived as, although, in some cases, the part of the wife is okay.

Senator D'AMATO. You say that in some cases it is all right if they let the wife go?

Mr. GALLAGHER. Yes. They can come and get her if the loan goes bad.

I just think it would create an awful lot of confusion, and I also question the fact that if it were a million-dollar project and, for instance, my bank had $500,000 in the deal and SBA had a $400,000 second, speaking for Long Island, real estate appreciates, and let's assume we are making prudent loans, and this company does not default for 3 or 4 years; I cannot conceive of your not being able to get $1 million for that same building 2 or 3 years later down the road. So I think the collateral, where the SBA is in a subordinate position, is fine.

Senator D'AMATO. Well, you heard one of the issues that was raised in terms of this identity situation, where you have a principal who owns the business and the equipment, and let's say his mother-in-law or father-in-law owns the land. Are you saying that the SBA is wrong in saying that you cannot have that situation?

Mr. GALLAGHER. No. I think, the way it stands now, it has to be a mirror image. It has to be the same ownership in both. I think you would have to look at each case individually. In that instance, I think SBA should be involved.

I think what goes further than that, though, is when you have to start getting developers involved in that type of thing. Then the question of using Government money to finance that type of project—but if it were a family-type situation, I see nothing wrong with it.

Senator D'AMATO. Well, would you insist that the family, the mirror image, then go on any guarantee? I mean, as the bank, you would do that, wouldn't you?

Mr. GALLAGHER. Right, but it depends on the strength of the company. You have to look at each situation differently. There are industrial revenue bonds we have done where we do not insist on personal guarantees. There are others where we do. I think you would have to look case by case on that.

But I think this program—I mean, really, what you are talking about here is leverage. If my bank tomorrow tells me, go out and do 10 million dollars' worth of industrial revenue bonds, and that $10 million builds 10 factories, if I can use the 503, I can build 20 factories, because now my allocation is double. So you are talking about leveraging it.

I think the program has the potential of being an excellent program, but it is underutilized because of these restrictions that we have.

Senator D'AMATO. Major restriction, IDB?

Mr. GALLAGHER. IDB.

Senator D'AMATO. Our success story, Jim D'Addario. Jim.

[The prepared statement of Mr. Gallagher follows:]

Chemical Bank

115 Broad Hollow Road, Melville, NY 11747
Tel (516) 549-7165

Donald H. Gallagher
Vice President

SENATE SMALL BUSINESS COMMITTEE
RUSSELL SENATE OFFICE BUILDING
WASHINGTON, D.C.
HONORABLE ALFONSE D'AMATO, CHAIRMAN
HEARING DATE: SEPTEMBER 28, 1982

My name is Donald Gallagher. I am a Vice President of Chemical Bank and responsible for industrial development/economic development. We areheavily involved in the financing of commercial and industrial properties in our market area and deal with expanding companies, companies who are creating new job opportunities. I have been involved in this type of financing for twelve years.

The question of how to finance a given project is a constant challenge. We have been the purchaser of numerous industrial revenue bonds over the last few years, but on the whole these have been purchased for companies showing very strong financial statements. On the other side of that coin is the smaller, solid business (which is really the backbone of our area) who creates new job opportunities, the type of company for whom a lender would not purchase 100% of a bond issue, but a company for whom a lender may consider purchasing a portion of the bond, say 50%. This is fine, but how do we accomplish the balance of the financing? The question of using the '503' program behind an IRB or JDA has been discussed in our area and in other areas. We question the argument that to combine an IRB with the SBA '503' being referred to as 'double dipping'. There have been reports made in our area which show that the use of IRBs produce tax revenues to the various governmental agencies far in excess of the loss caused by the tax exempt features of IRBs. The argument of 'double dipping' becomes weaker when we consider the broader issue of creating jobs and bringing the unemployment rate down. In recent years when the prime rate didn't fluctuate as at present and the thrift industry was healthy, it was relatively easy to finance an industrial project. The main area of lending by thrifts was long term mortgages at fixed rates for long periods of time, usually twenty years. If the project location was suitable and the company was credit worthy, a deal could be made. Today, the thrift industry has very little in the way of mortgage money and the demand for dollars is tremendous. The typical financing was a 50% first mortgage and a 40% second mortgage from the JDA. Today, we need every tool at our disposal to finance an industrial project.

Surely, companies who can afford to expand in this economy must find the proper financing tools to fund the building and land purchases on a long term basis as reasonably as possible. The overhead in companies today is extremely high and the cost of building and land financing must be kept to a minimum. The pressures on working capital and cash flow is crucial to the success of a small business. I would rather see a company avail themselves of 90% or 100% financing on building, land and equipment and retain their cash for use in the daily operation of the business or in research and development.

Let us take as an example a building of 30,000 sq. ft. at a cost of one million dollars. The thrift institution may no longer take the 50% first mortgage due to a smaller allocation for mortgages, but they may make a 40% first mortgage or $400,000. We may then ask the state to lend 40% in a second mortgage position. We should be able to request the SBA for a 10% third mortgage putting together a 90% long term mortgage package with the end result being lower monthly or annual payments than the cost to the company for the rental of the same size facility. Since we have the state involved in the financing (and this is tax exempt dollars) the '503' cannot be used. The company is now required to invest $200,000. rather than $100,000. in addition to moving expenses and all other costs inherent to a relocation.

Or, in this example, if a bank were to take a 50% position in the form of an industrial revenue bond and the company did not qualify for JDA, we should be able to turn to the '503' for a $400,000. second mortgage but we cannot as the program is not intended to be used behind tax exempt bonds. A company using this size facility may be creating forty or fifty new job opportunities over the next two or three years. This represents the real question and if we consider the amount of money that may be allocated to the '503' program, say $250,000,000, overall this represents a small investment on the part of the Federal government to help create the thousands of new job opportunities which, in turn, creates millions of dollars in tax revenue. We must create job opportunities and we can, but just as things change around us so must the tools that we need to build factories change.

In my opinion, the SBA '503' program should be able to be used with any other type of financing that is available, tax exempt or otherwise. We should be looking for ways to make financing easier, again to create employment. I, personally, would like to see the SBA lending authority raised to $750,000 $1,000,000. as half a million dollars does not go far these days - but that is a separate issue. We hear the argument that government should not be used in this type financing at all, but by the private sector entirely. In the past, that point could be argued for some time, but in today's market government financing is imperative if we are to build factories and R&D facilities. I would also like to point out that in dealing with small business, for every loan that is processed, three or four may have been turned down. Once an agency takes on a project a lot of time and effort is expended in an endeavor to bring the project to full maturity. We are making loans to the backbone of what this country is all about -- the solid small business.

STATEMENT OF JAMES D. D'ADDARIO, VICE PRESIDENT, J. D'ADDARIO & CO., INC., EAST FARMINGDALE, N.Y.

Mr. D'ADDARIO. Thank you, Senator, for inviting me here today. I have handed in a testimony, and I am not going to read the whole thing, but I think Don has made some great points.

Senator D'AMATO. How does 503 help you?

Mr. D'ADDARIO. Well, I would like to explain how 502 helped us and how, if we were in the situation today that we were in 3 years ago, our business could not have grown, with the help of Don and Chemical Bank, who happened to be our bank.

We were going to expand in 1979. We had at that time about 100 employees and we were renting a building, and so we went out to look. We needed 2½ times the space, and we were looking for rental space, and we saw what that would cost, and we also looked to buy a building. We got to meet Don and his staff, and they said, "Listen." They thought that they could help us put together a package, using a standard commercial mortgage, first mortgage, the JDA for about 30 percent, and the SBA's 502 at that time for the other remaining 10 percent.

He convinced us, by looking at our financial statements, that we would qualify, and so on. Of course, we didn't believe it for a long time. It took months before we got the approval. But the program was very successful. We got the financing. We were required only—his numbers are basically my numbers; our project was about $1 million. We only had to put up about $100,000. Now, that left us $100,000 to $150,000 of extra working capital to buy more equipment, advertise our products more, buy more raw materials, and keep more finished goods in inventory, and we kept the business running at a better rate.

If we had not been able to get the SBA, we would have been forced to put up an additional $100,000. That would have really hindered our growth. We would probably not have built the size building that we did, we would have run out of space earlier, and so on.

Anyway, it was very successful, and 2 years later, in 1981, September, we were in the position where we had to expand. So we created another project, which is a 16,000-square-foot addition on the building, and we were able to qualify for the 503 program because it was a separate project, and we had a first mortgage only.

But if it were today when we were getting our first building, with the present requirements on this program, I have got to say, we would not have been in the position we are now.

Senator D'AMATO. What requirements that exist today would preclude you?

Mr. D'ADDARIO. Well, our first expansion, the 25,000-square-foot building, was financed 50 percent with an insurance company, standard rate, and we had 30 percent with JDA, which is tax-exempt, and we have 10 percent with SBA. We would never have gotten the 10 percent, and we would have been forced——

Senator D'AMATO. The tax-exempt status would preclude it. Does the JDA preclude use of the 503 now?

Mr. GALLAGHER. They normally do, but in this case, seeing that the JDA was there, they allowed us to use the 503.

Mr. D'ADDARIO. It was a new project.

Senator D'AMATO. The question is, today, does the JDA preclude use of the 503?

Mr. D'ADDARIO. No, it is the other way around.

Senator D'AMATO. Pardon me.

Mr. GALLAGHER. When you bring the JDA into play, the 503 cannot come into the package because the JDA is tax-exempt.

Senator D'AMATO. That is the question. If you have JDA, then you cannot bring in 503. Is that correct?

Mr. D'ADDARIO. Right.

Senator D'AMATO. All right, so now we are not even talking about local industrial revenue bonds, but we are also talking about using those bonds that flow from the State.

Mr. D'ADDARIO. Right. We have now working for us 200 employees. We have a new company we acquired that started with 6 employees, and in that division we have 20 now, and by midyear we hope to have 40 or 50. Without this help, I do not think it would be possible.

I have to thank Mr. Gallagher and Mr. Gurian for their assistance.

[The prepared statement of Mr. D'Addario follows:]

James D'Addario
Vice-President
J. D'Addario & Company, Inc.
210 Route 109, E. Farmingdale, NY 11735 USA
US Senate Subcommittee on Urban and Rural Economic Development
Senate Small Business Committee
9/28/82

The reason I'm here today is to tell you a little bit about our company and to illustrate how the SBA's 502 and 503 programs were instrumental in helping our company expand, enabling us to create new job opportunities for our community.

J. D'Addario & Company, Inc was founded in 1973 and is an off shoot of a D'Addario family business which was started by my grandfather in NY in 1917. Our family has been in the business of crafting precision quality musical instrument strings for more than 100 years.

Until the onset of the guitar craze, spurred on by Elvis Presley and the Beatles, the music string business was always a small speciality business. In comparision with other consumer industries it still is, however, with the increased popularity of the guitar and other related instruments, what once was a small family business with 2 or 3 employees has grown to a 200 employee shop occupying 40,000 square feet in E. Farmingdale, Long Island.

Needless to say financing the growth of our business, from a 2000 square foot facility in 1973 to its present stage required a continuous flow of capital. When we outgrew our rented location in 1979, we made the decision to expand. We looked for appropriate rental space or for a suitable building to buy. It was obvious to us, that the most efficient expansion would be to design and build our own facility, keeping in mind our present and future requirements.

With the help of the staff of Chemical Bank and the Long Island Certified Development Coporation, in particular Mr. Gurian, we were able to put together a finance package using a standard commercial first mortgage, a second mortgage with the tax exempt NY State Job Development Authority and a third mortgage through the SBA's 502 program. Details of the financing package are attached.

In September 1981, two years after our move, we were faced with same problems we faced in 1979 - a shortage of manufacuring and warehouse space, a manufacturing backlog and the usual cash flow problems of a growing business. Again were able to attain funds through the SBA's current 503 program.

The type of financial help received was key in enabling us to build and buy more equipment, advertise our products more frequently throughout the world and keep the necessary raw materials and finished goods inventories required to give the kind of service we have built our reputation on.

Since our first expansion, in 1979, our factory staff has grown from 115 employees to 200. All of these positions have been filled by local unskilled workers who have been trained to do semi-skilled and in some cases highly specialized work.

Our most recent expansion has made it possible for our newly acquired Kaplan Violin String Division to grow from 6 to 20 employees since June 1982. And the future looks even better. We expect to have between 40 and 50 employees working in this new department by mid 1983.

Since 1973 we have built up our product line to over 1000 items. We are one of the few companies in the music industry to continually export to all markets competitively - including the Japanese.

In fact today 30% of our production is exported. Our products are sold in almost every country in the free world.

In order that you may understand exactly what our company and our product is all about, I have passed around several samples and a quantity of literature describing our product line and our company history.

I want to thank the committee for making programs such as the ones mentioned above possible and for letting me illustrate how these programs have benefited both our company and our community. If anyone has any questions, please feel free to ask. Thank you for your attention.

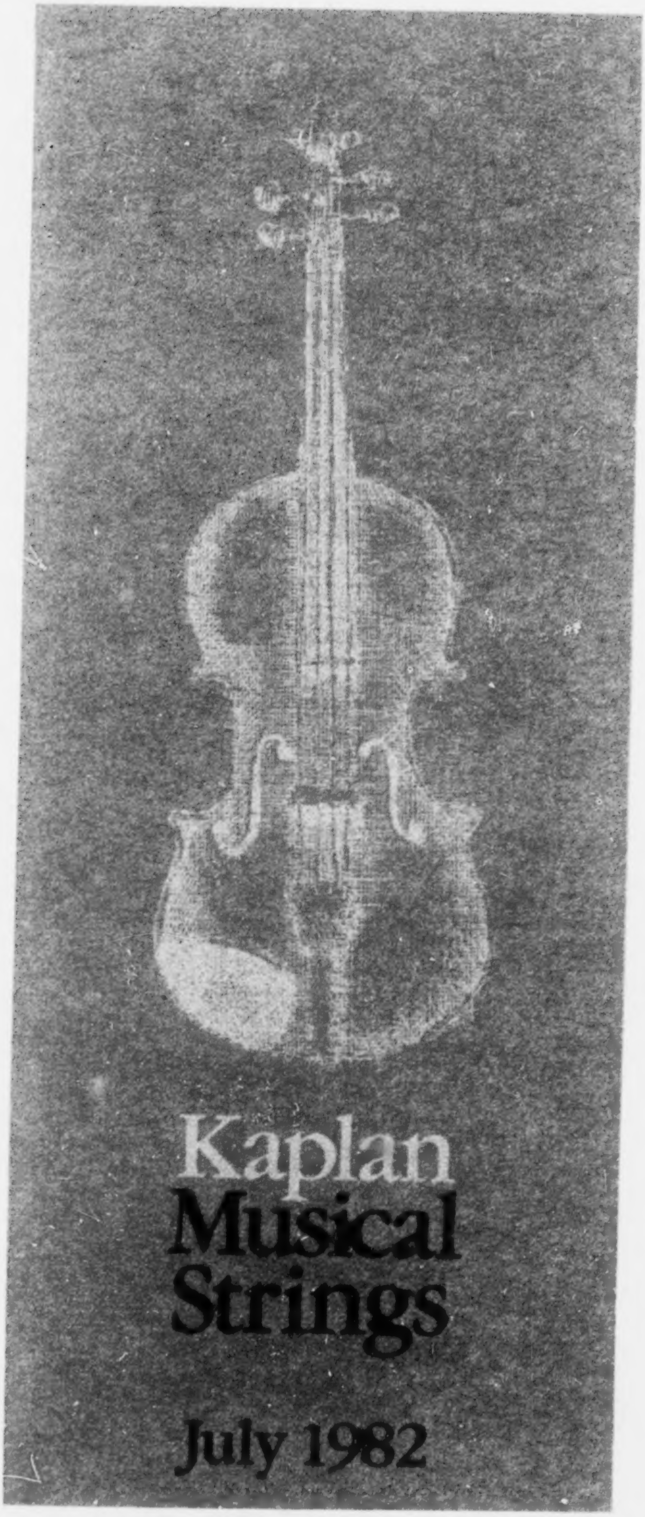
J. D'Addario & Company, Inc.
Manufacturing facility financing. 9/27/82

Costs

Cost of land	$175,000.00
Original 25,000 square foot facility (September 1979)	603,000.00
New 16,000 square foot facility (June 1982)	305,000.00

Financing

First mortgage-Equitable Life Insurance (9 3/4%)	$324,000.00
Second mortgage-NY Job Development Authority (8 1/4%)	220,000.00
Third mortgage-SBA 502 Program (7 3/8%)	175,000.00
Fourth mortage (new expansion)-SBA 503 Program (14.5%)	180,000.00



Kaplan
Musical
Strings

July 1982

GOLDEN-SPIRAL SOLO

Golden Spiral Solo Strings

Kaplan's premier string, Golden Spiral Solo strings are natural sheep gut strings that offer excellent flexibility, warm tone and subtle, sensitive response. Only the very finest Kaplan Strings are selected to bear the Golden Spiral Solo designation, and therefore they are available only in limited production quantities.

Golden Spiral Solo strings undergo rigorous testing and inspection at every crucial developmental stage to insure consistently perfect intonation. All preparation is done in special humidity controlled areas to guarantee perfect string diameter end to end. A Kaplan developed moisture inhibitor guards against gut swell or stretch; the cores are then precision wound, with appropriate aluminum or sterling silver ribbon wire.

Solo strings are available in various gauges and are packed one dozen per rigid plastic tube. Complete sets are also available in standard gauges, either straight (one set per tube) or carefully coiled in tarnish resistant paper envelopes packed in a vinyl pouch. Individual strings are available packed one dozen per rigid plastic tubes in the gauges list below.

Complete Violin Sets

No.	Description	Each
K475C	**Complete Violin Set-Coiled** Includes: Steel E-No. K420ML, Aluminum A-No. K424, Aluminum D-No. K425, Silver G-No. K450.	**$25.50**
K475S	**Complete Violin Set-Straight** Includes: Steel E-No. K420ML, Aluminum A-No. K424, Aluminum D-No. K425, Silver G-No. K450.	**25.50**
K495C	**Complete Violin Set-Coiled** Includes: Steel E-No. K420ML, Aluminum A-No. K424, Silver D-No. K440, Silver G-No. K450.	**26.50**
K495S	**Complete Violin Set-Straight** Includes: Steel E-No. K420ML, Aluminum A-No. K424, Silver D-No. K440, Silver G-No. K450.	**26.50**

Violin E Strings

No.	Description	Each
K420SB	Soft Tension-Ball End Steel	$ 1.80
K420MB	Medium Tension-Ball End Steel	1.80
K420HB	Hard Tension-Ball End Steel	1.80
K420SL	Soft Tension-Loop End Steel	1.80
K420ML	Medium Tension-Loop End Steel	1.80
K420HL	Hard Tension-Loop End Steel	1.80

Violin A Strings

No.	Description	Each
K424-1	13 Gauge-Aluminum on gut	$ 7.00
K424-2	13¼ Gauge-Aluminum on gut	7.00
K424-3	13½ Gauge-Aluminum on gut	7.00
K424-4	13¾ Gauge-Aluminum on gut	7.00
K424-5	14 Gauge-Aluminum on gut	7.00

Golden Spiral Solo cont.

Violin D Strings

No.	Description	Each
K425-1	16½ Gauge Aluminum on gut	$ 7.50
K425-2	16¾ Gauge-Aluminum on gut	7.50
K425-3	17 Gauge-Aluminum on gut	7.50
K425-4	17¼ Gauge-Aluminum on gut	7.50
K425-5	17½ Gauge-Aluminum on gut	7.50
K440-1	13 Gauge--Silver on gut	8.50
K440-2	13¼ Gauge--Silver on gut	8.50
K440-3	13½ Gauge--Silver on gut	8.50
K440-4	13¾ Gauge-Silver on gut	8.50
K440-5	14 Gauge-Silver on gut	8.50

Violin G Strings

No.	Description	Each
K450-1	15½ Gauge-Silver on gut	$ 9.00
K450-2	15¾ Gauge-Silver on gut	9.00
K450-3	16 Gauge-Silver on gut	9.00
K450-4	16¼ Gauge-Silver on gut	9.00
K450-5	16½ Gauge-Silver on gut	9.00

Complete Viola Sets

No.	Description	Each
K476C	**Complete Viola Set-Coiled**	**$39.00**

Includes: Aluminum A-No. K423, Aluminum D-No. K426, Silver G-No. K451, Silver C-No. K452.

No.	Description	Each
K476S	**Complete Viola Set-Straight**	**39.00**

Includes: Aluminum A-No. K423, Aluminum D-No. K426, Silver G-No. K451, Silver C-No. K452.

Viola A Strings

No.	Description	Each
K423S	Aluminum on gut-Straight	$ 7.85

Viola D Strings

No.	Description	Each
K426S	Aluminum on gut-Straight	$ 8.50

Viola G Strings

No.	Description	Each
K451S	Silver on gut-Straight	$10.00

Viola C Strings

No.	Description	Each
K452S	Silver on gut-Straight	$12.50

Classic Guitar Strings

No.	Description	Each
K700	Gut Trebles-Normal Tension*	$16.50
K710	Nylon Trebles-Normal Tension*	10.00
K720	Nylon Trebles-Hard Tension*	10.00

*Silverplated wound bass strings

GOLDEN·SPIRAL

Golden Spiral Strings

Kaplan Golden Spiral Strings provide exceptionally vibrant, warm response. Used by symphonic performers, teachers and serious students, Kaplan Golden Spiral Strings are natural gut which is specially processed, cured, stretched and polished. A unique moisture inhibitor is utilized to guard against gut swell or stretch, making the strings resistant to changes in humidity. The strings are then precision wound with the appropriate silver or aluminum windings, depending on the desired sound characteristics. Environmental control is vital. All Kaplan strings are prepared to exacting standards in low moisture climate controlled areas.

Golden Spiral Strings are available uncoiled in protective rigid plastic tubes (one dozen per tube) or coiled in tarnish resistant paper envelopes. Please specify when ordering. Complete sets are available, straight, one set per tube, or coiled, in tarnish resistant envelopes packed in a vinyl pouch. All steel E strings are coiled in envelopes, save those in sets which are packed straight in tubes.

Complete Violin Sets

No.	Description	Each
K470C	**Complete Violin Set-Coiled** .... Includes: Steel E-No. K400M, Aluminum A-No. K434, Aluminum D-No. K435, Silver G-No. K460.	**$23.00**
K470S	**Complete Violin Set-Straight** .... Includes: Steel E-No. K400M, Aluminum A-No. K434, Aluminum D-No. K435, Silver G-No. K460.	**23.00**
K490C	**Complete Violin Set-Coiled** .... Includes: Steel E-No. K400M, Aluminum A-No. K434, Silver D-No. K430, Silver G-No. K460.	**23.85**
K495S	**Complete Violin Set-Straight** .... Includes: Steel E-No. K400M, Aluminum A-No. K434, Silver D-No. K430, Silver G-No. K460.	**23.85**

Violin E Strings

No.	Description	Each
K400S	Soft Tension-Loop End Steel	$ 1.50
K400M	Medium Tension-Loop End Steel	1.50
K400H	Hard Tension-Loop End Steel	1.50

Violin A Strings

No.	Description	Each
K401S	Plain gut-Straight	$ 4.00
K434S	Aluminum on gut-Straight	6.25
K434C	Aluminum on gut-Coiled	6.25

Golden Spiral cont.

Violin D Strings

No.	Description	Each
K435S	Aluminum on gut-Straight	$ 6.75
K435C	Aluminum on gut-Coiled	6.75
K430S	Silver on gut-Straight	7.50
K430C	Silver on gut-Coiled	7.50

Violin G Strings

No.	Description	Each
K460S	Silver on gut-Straight	$ 8.35
K460C	Silver on gut-Coiled	8.35

Complete Viola Sets

No.	Description	Each
K471C	**Complete Viola Set-Coiled**	**$35.50**

Includes: Aluminum A-No. K433, Aluminum D-No. K436, Silver G-No. K461, Silver C-No. K462.

K471S	**Complete Viola Set-Straight**	**35.50**

Includes: Aluminum A-No. K433, Aluminum D-No. K436, Silver G-No. K461, Silver C-No. K462.

Viola A Strings

No.	Description	Each
K401½S	Plain gut-Straight	$ 4.50
K433S	Aluminum on gut-Straight	7.00
K433C	Aluminum on gut-Coiled	7.00

Viola D Strings

No.	Description	Each
K436S	Aluminum on gut-Straight	$ 7.50
K436C	Aluminum on gut-Coiled	7.50
K431S	Silver on gut-Straight	8.50
K431C	Silver on gut-Coiled	8.50

Viola G Strings

No.	Description	Each
K461S	Silver on gut-Straight	$ 9.25
K461C	Silver on gut-Coiled	9.25

Viola C Strings

No.	Description	Each
K462S	Silver on gut-Straight	$11.50
K462C	Silver on gut-Coiled	11.50

Kaplan Artcraft Rosin

All purpose rosin in convenient reusable felt pouch. Available in light or dark, packed 12 cakes to a display carton.

No.	Description	Each
KACR6	Light Rosin	**$ 4.00**
KACR7	Dark Rosin	**4.00**

RED·O·RAY
KAPLAN MUSICAL STRINGS, USA

Kaplan Red O Ray Strings

Introduced by Kaplan in the early 1900's, Red O Ray violin and viola strings are more popular today than ever. Natural sheep gut cores are dyed red and impregnated with Kaplan's special moisture inhibitor. This guards against gut swell and stretch and is especially resistant to changes in humidity. Red O Ray, like all Kaplan gut strings, are prepared in controlled low moisture environments to insure perfect intonation. Once completely cured and trued, the gut strings are wound with appropriate silver or aluminum windings. Red O Ray strings are also color coded for easy identification.

Red O Ray strings are available straight in rigid tubes, one dozen per tube, or coiled in tarnish resistant paper envelopes. (Please specify when ordering). Complete sets are available straight, one set per tube, or carefully coiled in tarnish resistant paper envelopes packed in a vinyl pouch.

Complete Violin Sets

No.	Description	Each
K570C	**Complete Violin Set-Coiled**	**$20.75**
	Includes: Steel E-No. K500M, Aluminum A-No. K534, Aluminum D-No. K535, Silver G-No. K560.	
K570S	**Complete Violin Set-Straight**	**20.75**
	Includes: Steel E-No. K500M, Aluminum A-No. K534, Aluminum D-No. K535, Silver G-No. K560.	

Violin E Strings

No.	Description	Each
K500M	Medium Tension-Loop End Steel	$ 1.35

Violin A Strings

No.	Description	Each
K501C	Plain red gut-Coiled	$ 3.60
K501S	Plain red gut-Straight	3.60
K534S	Aluminum on red gut-Straight	5.65
K534C	Aluminum on red gut-Coiled	5.65

Violin D Strings

No.	Description	Each
K535S	Aluminum on red gut-Straight	$ 6.00
K535C	Aluminum on red gut-Coiled	6.00

Violin G Strings

No.	Description	Each
K560S	Silver on red gut-Straight	$ 7.50
K560C	Silver on red gut-Coiled	7.50

Kaplan Red O Ray cont.

Complete Viola Sets

No.	Description	Each
K475C	**Complete Viola Set-Coiled** Includes: Aluminum A-No. K533, Aluminum D-No. K536, Silver G-No. K561, Silver C-No. K562.	**$31.85**
K475S	**Complete Viola Set-Straight** Includes: Aluminum A-No. K533, Aluminum D-No. K536, Silver G-No. K561, Silver C-No. K562.	**31.85**

Viola A Strings

No.	Description	Each
K501½S	Plain red gut-Straight	$ 6.35
K533S	Aluminum on red gut-Straight	6.35
K533C	Aluminum on red gut-Coiled	6.35

Viola D Strings

No.	Description	Each
K536S	Aluminum on red gut-Straight	$ 6.75
K536C	Aluminum on red gut-Coiled	6.75

Viola G Strings

No.	Description	Each
K561S	Silver on red gut-Straight	$ 8.50
K561C	Silver on red gut-Coiled	8.50

Viola C Strings

No.	Description	Each
K562S	Silver on red gut-Straight	$10.00
K562C	Silver on red gut-Coiled	10.00

Tone Craft

Tonecraft Strings

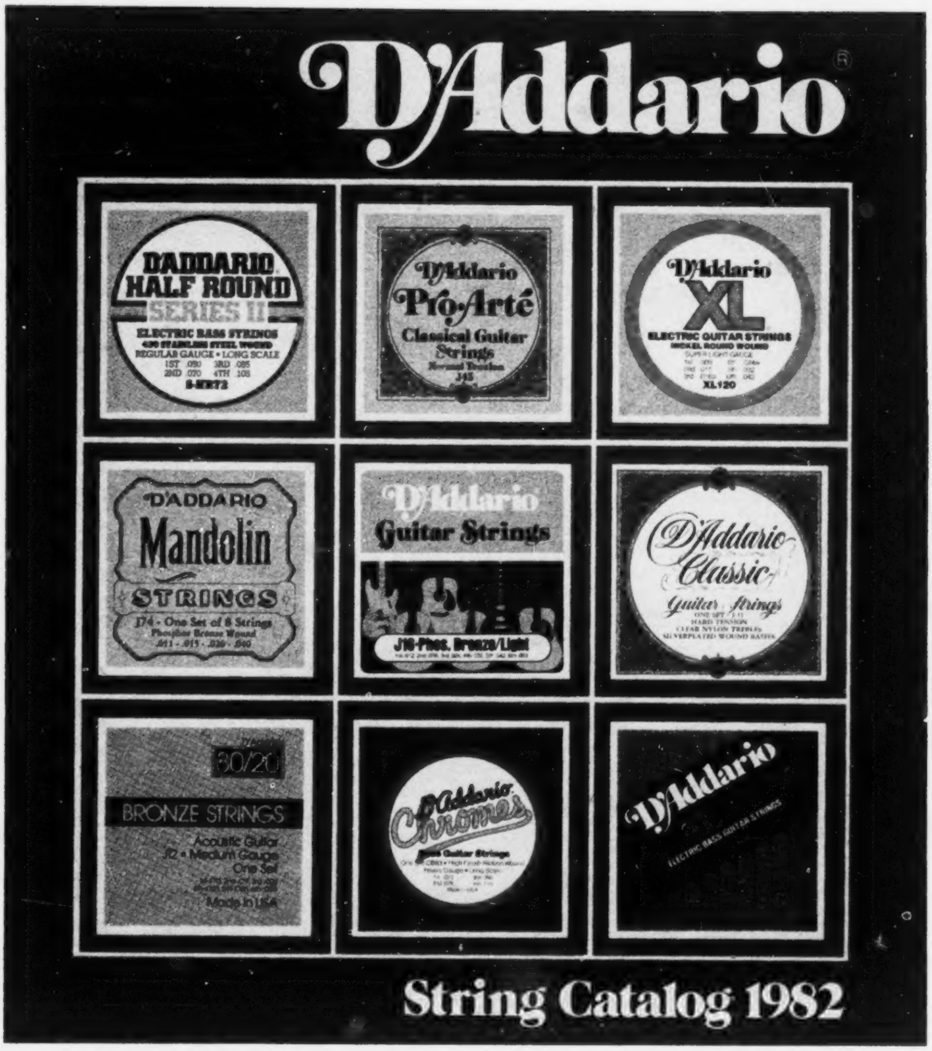
Tonecraft violin strings are designed for artists seeking the tone, flexibility and response of natural gut strings at an affordable price. Like all Kaplan Strings, Tonecraft strings are prepared to exacting standards in low moisture, climate controlled environments. They are available in sets only. Each set is packaged in tarnish resistant paper envelopes in a vinyl pouch.

Complete Violin Sets

No.	Description	Each
K670	**Complete Violin Set** Includes: Steel E, Aluminum A, Aluminum D, Silver G.	**$15.75**
K675	**Complete Violin Set** Includes: Steel E, Aluminum A, Silver D, Silver G.	**16.50**

Kaplan Musical Strings
A division of J. D'Addario & Company, Inc.
210 Rte. 109, PO Box J
E. Farmingdale, NY 11735 USA
Phone: 516/454-9450 Telex: 143196

Note: Kaplan cello and bass strings are temporarily out of production.



D'Addario®

String Catalog 1982

D'ADDARIO HALF ROUND SERIES II
ELECTRIC BASS STRINGS
REGULAR GAUGE • LONG SCALE
D'Addario Pro·Arté
Classical Guitar Strings
J45
D'Addario XL
ELECTRIC GUITAR STRINGS
NICKEL ROUND WOUND
SUPER LIGHT GAUGE
XL120
D'ADDARIO Mandolin STRINGS
J74 - One Set of 8 Strings
Phosphor Bronze Wound
D'Addario Guitar Strings
J16-Phos. Bronze/Light
D'Addario Classic
Guitar Strings
HARD TENSION
CLEAR NYLON TREBLES
SILVERPLATED WOUND BASSES
80/20
BRONZE STRINGS
Acoustic Guitar
J12 • Medium Gauge
One Set
Made in USA
D'Addario Chromes
D'Addario
ELECTRIC BASS GUITAR STRINGS

The sound a musical instrument string creates is a beautiful thing. Today however, it gets more and more difficult for a musician to select the right strings for his instrument, his style of playing and for the tone desired.

This guide can help make that selection easier without you requiring a degree in physics, metallurgy, or chemistry. This is a guide, not a bible. Its informational content is objective, the result of years of research and consultation with scientists and musicians. It's also subjective in the sense that it's based on theories and opinions of J. D'Addario & Co., Inc. We hope it will help you understand the essence of each type of string and what differentiates one string from another.

Basic String Construction:

Steel Guitar Strings-Acoustic/Electric

Both acoustic and electric six string guitars have either 3 or 4 wound strings and 2 or 3 plain strings per set. The actual breakdown depends on desired gauge or tension. Generally, plain or unwound strings are made of high carbon tinned steel wire. This performs well on either acoustic or electric guitars.

D'Addario plain strings are designed to perform equally well on any guitar including those fine acoustic guitars with extra short bridge and saddle configurations. We use a special securely wrapped extra short double or lock twist on all our plain strings (see fig. 1). This helps avoid any possibility of buzzing or uneven string vibration caused by the twisted portion of the string coming up over the saddle.

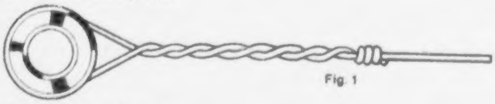


Fig. 1

D'Addario offers other new and exclusive features in it's plain steel strings. In 1982 we are introducing for the first time, on an individual string basis (not in sets), half or intermediate diameters never before available for guitar. They include .0085, .0095, .0105, .0115. This will give the guitarist even more flexibility when making custom gauged sets or replacing worn or broken plain strings.

Core Wire

Steel strings are wound on a high carbon steel core wire similar to the wire used to create plain guitar strings. Wound strings involve a difficult decision for the manufacturer. Round core wire or the more expensive hexagonal core wire? On a round core wire there's nothing to grip or secure the wrap wire to the core. Typically, the wrap separates or actually loosens on the core causing the string to go dead.

Stringmakers have devised many different ways to secure the wrap wire to the core. All of them work, but offer a compromise in one way or another.

D'Addario uses only precisely shaped and tested hexagonal core wire to make D'Addario strings. It's proven to be the best method of holding wrap wire on a core. The cross section (see fig. 2) of a wound string using a hexagonal core shows six core wire corners firmly gripping every turn of wrap wire (approximately 7800 turns on a string .022 in diameter.) A string made this way is more dependable in that it's wrapped the most secure way. The end result is a durable string that lasts longer and one that vibrates more evenly, all essential to good sound.

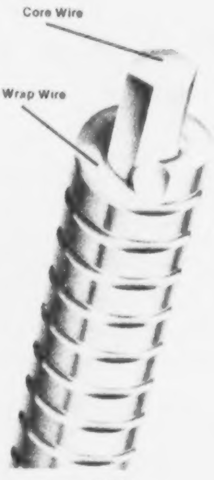


Fig. 2

Fig. 3

Rectified D'Addario Classic Series treble string
Monofilament nylon before rectifying

Classical/Nylon Guitar Strings

Classical guitar string sets normally have three plain nylon strings and three wound on nylon strings.

Plain Nylon Treble Strings

After the introduction of nylon in the 1940's, manufacturers had a limited source to choose material from—use commercially available nylon from Dupont or use none at all. It was the same material used to make brush bristles and fishing line. Not surprisingly the tolerances in diameter and consistency acceptable for these industries proved to be inadequate for guitar string making. As a result, guitar string manufacturers would sort through the Dupont material and by gauging and testing, suitable material for guitar strings was selected. It's a method in wide use even today.

In 1975 J. D'Addario & Co. developed a system for rectifying irregular nylon material to make it dimensionally precise all along its length (± .0002 of an inch). In order to produce a finished string .032" in diameter, we start with material approximately .036" and precisely remove the excess material leaving a perfectly round and consistent .032" string (see fig. 3).

The results? Perfect intonation-everytime-something never before available in a nylon treble string. Strings made this way are available in the D'Addario Classic Series (sets J28, J29, J30, J3l and on an individual string basis).

In 1978 D'Addario went another step forward and developed a completely new nylon, the first designed and manufactured exclusively for the guitar. The new formula produces a harder, denser material. It's extruded five times slower than commercially available material used by other stringmakers. The sound produced is crisp, with true tone and incredible sustain. Acclaimed by professionals all over the world, these new treble strings are available only in the D'Addario Pro Arte line, (sets J45, J46, J47, J48, J49, J50 and on an individual string basis).

Wound On Nylon Basses

They're made by winding wire on a multifilament (sometimes called floss) nylon. D'Addario uses a special floss formulation that minimizes stretch and offers strength and durability. Of course different core sizes are used to create different finished string gauges and tensions. All D'Addario Classic and D'Addario Pro-Arte wound strings are produced on our exclusive computer controlled machinery.

Wrap Wire Types

There are thousands of metal alloys to choose from when making wrap wire for musical strings. The guitarist's ever-changing appetite for new and better sound has made him more demanding as to the types of windings he wants on his strings. D'Addario has been instrumental in introducing new and innovative wrap wire materials to the music string industry. Below is a list of some of the more popular wrap materials in use today, and a guide to their individual sound characteristics.

80/20 Bronze

This alloy is made of 80% copper and 20% tin. Often called bronze, bright bronze, brass, or yellow brass, strings made with this alloy offer unsurpassed tonal range when new. The low strings have a strong bass response while all the wound strings have an unusually vibrant, brilliant tone. Great for penetrating acoustic guitar sound while new, they lose their initial super brilliance after a few hours of use. (Perspiration, climate and finger pressure while fretting are variables that determine life). However, the remaining tone is still pleasant and penetrating. Some guitarists prefer the second sound, though many restring after each performance or session.

Phosphor Bronze

Introduced to the music world by D'Addario in the mid-70's, the new phosphor bronze wound strings were an immediate hit. They were quickly imitated, but we feel never equaled.

D'Addario phosphor bronze strings deliver a more even, significantly longer lasting tone than their 80/20 counterparts. New, they offer some 80% of the brilliance of a new 80/20 set; however they retain their sound for a much longer period, thanks to the small but significant phosphorous content. Phosphor bronze strings also provide more sustain.

Nickel Wound

The nickel wire used in most popular electric guitar string sets today is really a low carbon steel wire with a heavy percentage of nickel plating. This plating gives the appearance and more importantly, the ductility of pure nickel wire. The steel offers the highly magnetic characteristics necessary to produce great volume and brightness on an electric guitar with magnetic pickups. Excellent for stage and recording work, these strings give a strong performance on both acoustic or electric guitars. They're also very popular with pedal steel and electric bass players. D'Addario's nickel plated steel formula wrap (used on all D'Addario XL string sets) has become an industry standard.

Stainless Steel Alloy

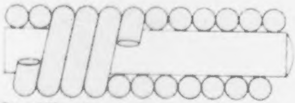
Stainless steel alloys are largely non-magnetic. However, D'Addario uses a special magnetic 430 alloy which maintains stainless steel's non-oxidizing characteristics. These strings offer exceptionally brilliant tone and have proven to be a favorite of many guitarists and bassists. Due to their anti-corrosive characteristics, these strings are resistant to the effects of perspiration and normal humidity—and they last significantly longer than their nickel counterparts. This alloy is also ideally suited for electric guitar or bass and puts out excellent sound on acoustic guitars with piezo pickups.

New Copper Coated Steel

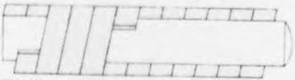
The introduction of XL Reds, the first copper coated steel electric bass string is destined to revolutionize the industry. Made and tempered specifically for modern bass players, who often take the spotlight, this new alloy is a special formulation of copper and steel. A highly magnetic steel wire is used which is then drawn and bonded to a special copper shell. The result is a russet colored string whose wrap wire is 70% steel with a 30% copper covering. The copper imparts a clear, piano-like punch while the steel gives strength and needed magnetic characteristics for use on amplified instruments.

Silverplated Copper

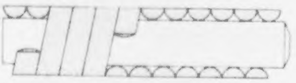
Silverplated copper wire wound on a steel core was long the standard of the industry. Superceded by 80/20, phosphor bronze and other alloys, use of this material has shrunken dramatically. However, copper wire with a silverplating has proven to be the best sounding alloy for the winding of classical guitar strings. The silverplating provides cosmetic appeal while producing a smooth fingering surface that does not wear frets prematurely.



Round Wound



Flat Wound



D'Addario Half Round* **Fig. 4**

Wrap wire shapes

Basically, wrap wire shapes can be categorized into three varieties: Round wound, flat wound and half round (see fig. 4).

Round Wound

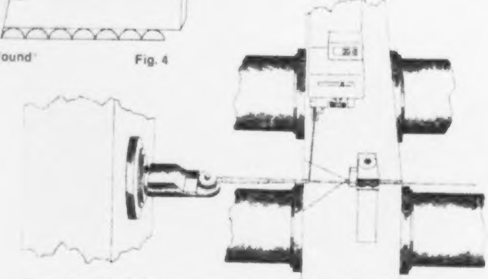
Round wound strings are by far today's most popular type, due to their broad tonal range and perfect intonation. Round wound refers only to the shape of the wrap wire. The round wound string is the brightest sounding type of the three.

Flat Wound

The uncolored sound of flat wounds make them popular with guitarists like Pat Metheny who create their unique tone color with a series of electronic effect devices. However, all flat wound strings compromise brilliance for a more mellow tone and easier fingering. D'Addario Chromes are wrapped with a chrome stainless steel flat wire. They're then polished to a smooth high finish exterior. They also offer very low finger noise (particularly desireable for recording work) and are easy on the frets.

D'Addario Half Round*

D'Addario introduced the third kind of string, the Half Round concept, in 1976. They filled the void between the tone characteristics of round and flat wound strings. Half Rounds start as precision wound, oversized round wound strings in either pure nickel (the original Half Rounds) or stainless steel (Series II Half Rounds). The wound string is then precision ground to the desired diameter leaving the surface of the finished string similar to a flat wound. The Half Round string produces sound characteristics that combine the best attributes of round wound and flat wound strings—great flexibility, accurate intonation and long life.



Computer controlled winding aparatus

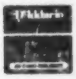
The choice is yours.

As you see, many factors can affect the sound a string produces. We feel that player preference is always the ultimate test. When you decide on which D'Addario string set fits your desired sound and your style of playing, you can be assured that each and every set you purchase in the future will meet the same tough standards for long life and superior sound. The D'Addario family is continually seeking ways to expand the state of the art of stringmaking. It's been our tradition for eight generations. After all, making fine strings is our only business.

Acoustic Guitar

Phosphor Bronze Wound

Set J15—Extra-Light Gauge

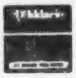


Cat.No.	Note	Description	Inch	mm
PL010	E-1st	Plain Steel	.010	.25
PL014	B-2nd	Plain Steel	.014	.36
PB023	G-3rd	Phosphor	.023	.58
PB030	D-4th	Phosphor	.030	.76
PB039	A-5th	Phosphor	.039	.99
PB047	E-6th	Phosphor	.047	1.19

Set J16—Light Gauge

Cat.No.	Note	Description	Inch	mm
PL012	E-1st	Plain Steel	.012	.30
PL016	B-2nd	Plain Steel	.016	.41
PB024	G-3rd	Phosphor	.024	.61
PB032	D-4th	Phosphor	.032	.81
PB042	A-5th	Phosphor	.042	1.07
PB053	E-6th	Phosphor	.053	1.35

Set J17—Medium Gauge

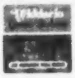


Cat.No.	Note	Description	Inch	mm
PL013	E-1st	Plain Steel	.013	.33
PL017	B-2nd	Plain Steel	.017	.43
PB026	G-3rd	Phosphor	.026	.66
PB035	D-4th	Phosphor	.035	.89
PB045	A-5th	Phosphor	.045	1.14
PB056	E-6th	Phosphor	.056	1.42

Set J18—Heavy Gauge

Cat.No.	Note	Description	Inch	mm
PL014	E-1st	Plain Steel	.014	.36
PL018	B-2nd	Plain Steel	.018	.46
PB027	G-3rd	Phosphor	.027	.69
PB039	D-4th	Phosphor	.039	.99
PB049	A-5th	Phosphor	.049	1.24
PB059	E-6th	Phosphor	.059	1.50

Set J19—Bluegrass Gauge



Cat.No.	Note	Description	Inch	mm
PL012	E-1st	Plain Steel	.012	.30
PL016	B-2nd	Plain Steel	.016	.41
PB025	G-3rd	Phosphor	.025	.64
PB035	D-4th	Phosphor	.035	.89
PB045	A-5th	Phosphor	.045	1.14
PB056	E-6th	Phosphor	.056	1.42

Set J38—12 String Light Gauge

Cat.No.	Note	Description	Inch	mm
PL010	E-1st	Plain Steel	.010	.25
PL010	E-2nd	Plain Steel	.010	.25
PL014	B-3rd	Plain Steel	.014	.36
PL014	B-4th	Plain Steel	.014	.36
PB023	G-5th	Phosphor	.023	.58
PL008	G-6th	Plain Steel	.008	.20
PB030	D-7th	Phosphor	.030	.76
PL012	D-8th	Plain Steel	.012	.30
PB039	A-9th	Phosphor	.039	.99
PL018	A-10th	Plain Steel	.018	.46
PB047	E-11th	Phosphor	.047	1.19
PB027	E-12th	Phosphor	.027	.69

Set J39—12 String Medium Gauge

Cat.No.	Note	Description	Inch	mm
PL012	E-1st	Plain Steel	.012	.30
PL012	E-2nd	Plain Steel	.012	.30
PL016	B-3rd	Plain Steel	.016	.41
PL016	B-4th	Plain Steel	.016	.41
PB025	G-5th	Phosphor	.025	.64
PL010	G-6th	Plain Steel	.010	.25
PB032	D-7th	Phosphor	.032	.81
PL014	D-8th	Plain Steel	.014	.36
PB042	A-9th	Phosphor	.042	1.07
PL020	A-10th	Plain Steel	.020	.51
PB052	E-11th	Phosphor	.052	1.32
PB030	E-12th	Phosphor	.030	.76

Set J41—12 String X-Light Gauge

Cat.No.	Note	Description	Inch	mm
PL009	E-1st	Plain Steel	.009	.23
PL009	E-2nd	Plain Steel	.009	.23
PL013	B-3rd	Plain Steel	.013	.33
PL013	B-4th	Plain Steel	.013	.33
PB021	G-5th	Phosphor	.021	.53
PL008	G-6th	Plain Steel	.008	.20
PB029	D-7th	Phosphor	.029	.74
PL011	D-8th	Plain Steel	.011	.28
PB036	A-9th	Phosphor	.036	.91
PL016	A-10th	Plain Steel	.016	.41
PB045	E-11th	Phosphor	.045	1.14
PB026	E-12th	Phosphor	.026	.66

Stefan Grossman

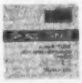
John Renbourn

Norman Blake

Acoustic Guitar

80/20 Bronze Wound

Set J10—Extra-Light Gauge



Cat.No.	Note	Description	Inch	mm
PL010	E-1st	Plain Steel	.010	.25
PL014	B-2nd	Plain Steel	.014	.36
BW023	G-3rd	80/20 Bronze	.023	.58
BW030	D-4th	80/20 Bronze	.030	.76
BW039	A-5th	80/20 Bronze	.039	.99
BW047	E-6th	80/20 Bronze	.047	1.19

Set J11—Light Gauge

Cat.No.	Note	Description	Inch	mm
PL012	E-1st	Plain Steel	.012	.30
PL016	B-2nd	Plain Steel	.016	.41
BW024	G-3rd	80/20 Bronze	.024	.61
BW032	D-4th	80/20 Bronze	.032	.81
BW042	A-5th	80/20 Bronze	.042	1.07
BW053	E-6th	80/20 Bronze	.053	1.35

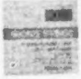
Set J12—Medium Gauge

Cat.No.	Note	Description	Inch	mm
PL013	E-1st	Plain Steel	.013	.33
PL017	B-2nd	Plain Steel	.017	.43
BW026	G-3rd	80/20 Bronze	.026	.66
BW035	D-4th	80/20 Bronze	.035	.89
BW045	A-5th	80/20 Bronze	.045	1.14
BW056	E-6th	80/20 Bronze	.056	1.42

Set J14—Bluegrass Gauge

Cat.No.	Note	Description	Inch	mm
PL012	E-1st	Plain Steel	.012	.30
PL016	B-2nd	Plain Steel	.016	.41
BW025	G-3rd	80/20 Bronze	.025	.64
BW035	D-4th	80/20 Bronze	.035	.89
BW045	A-5th	80/20 Bronze	.045	1.14
BW056	E-6th	80/20 Bronze	.056	1.42

Set J36—12 String Light Gauge



Cat.No.	Note	Description	Inch	mm
PL010	E-1st	Plain Steel	.010	.25
PL010	E-2nd	Plain Steel	.010	.25
PL014	B-3rd	Plain Steel	.014	.36
PL014	B-4th	Plain Steel	.014	.36
BW023	G-5th	80/20 Bronze	.023	.58
PL008	G-6th	Plain Steel	.008	.20
BW030	D-7th	80/20 Bronze	.030	.76
PL012	D-8th	Plain Steel	.012	.30
BW039	A-9th	80/20 Bronze	.039	.99
PL018	A-10th	Plain Steel	.018	.46
BW047	E-11th	80/20 Bronze	.047	1.19
BW027	E-12th	80/20 Bronze	.027	.69

Electric Guitar

XL® Nickel Round Wound

Set XL110—Regular Light Gauge

Cat.No.	Note	Description	Inch	mm
PL010	E-1st	Plain Steel	010	25
PL013	B-2nd	Plain Steel	013	33
PL017	G-3rd	Plain Steel	017	43
NW026	D-4th	Nickel	026	66
NW036	A-5th	Nickel	036	91
NW046	E-6th	Nickel	046	1.17

Set XL115—Jazz/Rock Gauge

Cat.No.	Note	Description	Inch	mm
PL011	E-1st	Plain Steel	011	28
PL014	B-2nd	Plain Steel	014	36
PL018	G-3rd	Plain Steel	018	46
NW028	D-4th	Nickel	028	71
NW038	A-5th	Nickel	038	97
NW049	E-6th	Nickel	049	1.24

Set XL120—Super Light Gauge

Cat.No.	Note	Description	Inch	mm
PL009	E-1st	Plain Steel	009	23
PL011	B-2nd	Plain Steel	011	28
PL016	G-3rd	Plain Steel	016	41
NW024	D-4th	Nickel	024	61
NW032	A-5th	Nickel	032	81
NW042	E-6th	Nickel	042	1.07

Set XL130—X-Super Light Gauge

Cat.No.	Note	Description	Inch	mm
PL008	E-1st	Plain Steel	008	20
PL010	B-2nd	Plain Steel	010	25
PL015	G-3rd	Plain Steel	015	38
NW021	D-4th	Nickel	021	53
NW030	A-5th	Nickel	030	76
NW038	E-6th	Nickel	038	97

Set XL140—Lite Top/Hvy Bottom

Cat.No.	Note	Description	Inch	mm
PL010	E-1st	Plain Steel	010	25
PL013	B-2nd	Plain Steel	013	33
PL017	G-3rd	Plain Steel	017	43
NW030	D-4th	Nickel	030	76
NW042	A-5th	Nickel	042	1.07
NW052	E-6th	Nickel	052	1.32

Set XL150—12 String Super Light

Cat.No.	Note	Description	Inch	mm
PL009	E-1st	Plain Steel	009	23
PL009	E-2nd	Plain Steel	009	23
PL011	B-3rd	Plain Steel	011	28
PL011	B-4th	Plain Steel	011	28
PL015	G-5th	Plain Steel	015	38
PL008*	G-6th	Plain Steel	008	20
NW024	D-7th	Nickel	024	61
PL011	D-8th	Plain Steel	011	28
NW032	A-9th	Nickel	032	81
PL016	A-10th	Plain Steel	016	41
NW042	E-11th	Nickel	042	1.07
NW021	E-12th	Nickel	021	53

*Set includes extra G octave (.008)

John McLaughlin

Fernando Saunders

Alphonso Johnson

Electric Guitar

XL® Nickel (cont.)

Set XL110W—Reg. Light/Wd 3rd

Cat.No.	Note	Description	Inch	mm
PL010	E-1st	Plain Steel	010	25
PL013	B-2nd	Plain Steel	013	33
NW018	G-3rd	Nickel	018	46
NW026	D-4th	Nickel	026	66
NW036	A-5th	Nickel	036	91
NW046	E-6th	Nickel	046	1.17

Set XL115W—Jazz/Rock/Wd 3rd

Cat.No.	Note	Description	Inch	mm
PL011	E-1st	Plain Steel	011	28
PL014	B-2nd	Plain Steel	014	36
NW021	G-3rd	Nickel	021	53
NW028	D-4th	Nickel	028	71
NW038	A-5th	Nickel	038	97
NW049	E-6th	Nickel	049	1.24

Set J20—Jazz Extra-Light

Cat.No.	Note	Description	Inch	mm
PL010	E-1st	Plain Steel	010	25
PL014	B-2nd	Plain Steel	014	36
NW022	G-3rd	Nickel	022	56
NW030	D-4th	Nickel	030	76
NW038	A-5th	Nickel	038	97
NW049	E-6th	Nickel	049	1.24

Set J21—Jazz Light Gauge

Cat.No.	Note	Description	Inch	mm
PL012	E-1st	Plain Steel	012	30
PL016	B-2nd	Plain Steel	016	41
NW024	G-3rd	Nickel	024	61
NW032	D-4th	Nickel	032	81
NW042	A-5th	Nickel	042	1.07
NW052	E-6th	Nickel	052	1.32

Set J22—Jazz Medium Gauge

Cat.No.	Note	Description	Inch	mm
PL013	E-1st	Plain Steel	013	33
PL017	B-2nd	Plain Steel	017	43
NW026	G-3rd	Nickel	026	66
NW036	D-4th	Nickel	036	91
NW046	A-5th	Nickel	046	1.17
NW056	E-6th	Nickel	056	1.42

Pedal Steel Guitar

XL® Nickel Round Wound

Set XL190—10 String/E-9th

Cat.No.	Note	Description	Inch	mm
PL012	F#-1st	Plain Steel	012	30
PL015	Eb-2nd	Plain Steel	015	38
PL010	G#-3rd	Plain Steel	010	25
PL014	E-4th	Plain Steel	014	36
PL018	B-5th	Plain Steel	018	46
NW020	G#-6th	Nickel	020	51
NW026	F#-7th	Nickel	026	66
NW030	E-8th	Nickel	030	76
NW034	D-9th	Nickel	034	86
NW038	B-10th	Nickel	038	97

Set XL200—8 String/C-6th

Cat.No.	Note	Description	Inch	mm
PL016	E-1st	Plain Steel	016	41
PL017	C-2nd	Plain Steel	017	43
NW021	A-3rd	Nickel	021	53
NW028	F-4th	Nickel	028	71
NW030	E-5th	Nickel	030	76
NW034	C-6th	Nickel	034	86
NW038	A-7th	Nickel	038	97
NW048	F-8th	Nickel	048	1.22
PL009*	G-1st	Plain Steel	009	23

*Optional G 1st included

Set XL210—10 String/C-6th

Cat.No.	Note	Description	Inch	mm
PL010	G-1st	Plain Steel	010	25
PL014	E-2nd	Plain Steel	014	36
NW018	C-3rd	Nickel	018	46
NW022	A-4th	Nickel	022	56
NW024	G-5th	Nickel	024	61
NW030	E-6th	Nickel	030	76
NW036	C-7th	Nickel	036	91
NW042	A-8th	Nickel	042	1.07
NW052	F-9th	Nickel	052	1.32
NW062	C-10th	Nickel	062	1.57

Electric Guitar
D'Addario Half Round® Series II-Stainless Steel

Set HR310—Regular Light Gauge

Cat.No	Note	Description	Inch	mm
PL010	E-1st	Plain Steel	.010	.25
PL013	B-2nd	Plain Steel	.013	.33
PL017	G-3rd	Plain Steel	.017	.43
HRG026	D-4th	Stainless	.026	.66
HRG036	A-5th	Stainless	.036	.91
HRG046	E-6th	Stainless	.046	1.17

Set HR320—Super Light Gauge

Cat.No	Note	Description	Inch	mm
PL009	E-1st	Plain Steel	.009	.23
PL011	B-2nd	Plain Steel	.011	.28
PL016	G-3rd	Plain Steel	.016	.41
HRG024	D-4th	Stainless	.024	.61
HRG032	A-5th	Stainless	.032	.81
HRG042	E-6th	Stainless	.042	1.07

Set HR330—X-Super Light Gauge

Cat.No	Note	Description	Inch	mm
PL008	E-1st	Plain Steel	.008	.20
PL010	B-2nd	Plain Steel	.010	.25
PL015	G-3rd	Plain Steel	.015	.38
HRG022	D-4th	Stainless	.022	.56
HRG030	A-5th	Stainless	.030	.76
HRG039	E-6th	Stainless	.039	.99

Set HR340—Lite Top/Hvy Bottom

Cat.No	Note	Description	Inch	mm
PL010	E-1st	Plain Steel	.010	.25
PL013	B-2nd	Plain Steel	.013	.33
PL017	G-3rd	Plain Steel	.017	.43
HRG030	D-4th	Stainless	.030	.76
HRG042	A-5th	Stainless	.042	1.07
HRG052	E-6th	Stainless	.052	1.32

Set HR350—Jazz Light Gauge

Cat.No	Note	Description	Inch	mm
PL012	E-1st	Plain Steel	.012	.30
PL016	B-2nd	Plain Steel	.016	.41
HRG024	G-3rd	Stainless	.024	.61
HRG032	D-4th	Stainless	.032	.81
HRG042	A-5th	Stainless	.042	1.07
HRG052	E-6th	Stainless	.052	1.32

Set HR360—Jazz Medium Gauge

Cat.No	Note	Description	Inch	mm
PL013	E-1st	Plain Steel	.013	.33
PL017	B-2nd	Plain Steel	.017	.43
HRG026	G-3rd	Stainless	.026	.66
HRG036	D-4th	Stainless	.036	.91
HRG046	A-5th	Stainless	.046	1.17
HRG056	E-6th	Stainless	.056	1.42

Pat Metheny

Rodney Jones

Mark Egan

Electric Guitar
XLS® Stainless Steel Round Wound

Set XLS510—Regular Light Gauge

Cat.No	Note	Description	Inch	mm
PL010	E-1st	Plain Steel	.010	.25
PL013	B-2nd	Plain Steel	.013	.33
PL017	G-3rd	Plain Steel	.017	.43
XSG026	D-4th	Stainless	.026	.66
XSG036	A-5th	Stainless	.036	.91
XSG046	E-6th	Stainless	.046	1.17

Set XLS520—Super Light Gauge

Cat.No	Note	Description	Inch	mm
PL009	E-1st	Plain Steel	.009	.23
PL011	B-2nd	Plain Steel	.011	.28
PL016	G-3rd	Plain Steel	.016	.41
XSG024	D-4th	Stainless	.024	.61
XSG032	A-5th	Stainless	.032	.81
XSG042	E-6th	Stainless	.042	1.07

Set XLS530—X-Super Light Gauge

Cat.No.	Note	Description	Inch	mm
PL008	E-1st	Plain Steel	.008	.20
PL010	B-2nd	Plain Steel	.010	.25
PL015	G-3rd	Plain Steel	.015	.38
XSG021	D-4th	Stainless	.021	.53
XSG030	A-5th	Stainless	.030	.76
XSG038	E-6th	Stainless	.038	.97

Set XLS540—Lite Top/Hvy Bottom

Cat.No	Note	Description	Inch	mm
PL010	E-1st	Plain Steel	.010	.25
PL013	B-2nd	Plain Steel	.013	.33
PL017	G-3rd	Plain Steel	.017	.43
XSG030	D-4th	Stainless	.030	.76
XSG042	A-5th	Stainless	.042	1.07
XSG052	E-6th	Stainless	.052	1.32

Set XLS590—Jazz Light Gauge

Cat.No	Note	Description	Inch	mm
PL012	E-1st	Plain Steel	.012	.30
PL016	B-2nd	Plain Steel	.016	.41
XSG024	G-3rd	Stainless	.024	.61
XSG032	D-4th	Stainless	.032	.81
XSG042	A-5th	Stainless	.042	1.07
XSG052	E-6th	Stainless	.052	1.32

Set XLS600—Jazz Medium Gauge

Cat.No	Note	Description	Inch	mm
PL013	E-1st	Plain Steel	.013	.33
PL017	B-2nd	Plain Steel	.017	.43
XSG026	G-3rd	Stainless	.026	.66
XSG036	D-4th	Stainless	.036	.91
XSG046	A-5th	Stainless	.046	1.17
XSG056	E-6th	Stainless	.056	1.42

Electric Guitar
D'Addario Chromes® Flat Wound

Set CG24—Jazz Light Gauge

Cat.No	Note	Description	Inch	mm
PL011	E-1st	Plain Steel	.011	.28
PL015	B-2nd	Plain Steel	.015	.38
CG022	G-3rd	Flat Wound	.022	.56
CG030	D-4th	Flat Wound	.030	.76
CG040	A-5th	Flat Wound	.040	1.02
CG050	E-6th	Flat Wound	.050	1.27

Set CG25—Light Gauge

Cat.No.	Note	Description	Inch	mm
PL012	E-1st	Plain Steel	.012	.30
PL016	B-2nd	Plain Steel	.016	.41
CG024	G-3rd	Flat Wound	.024	.61
CG032	D-4th	Flat Wound	.032	.81
CG042	A-5th	Flat Wound	.042	1.07
CG052	E-6th	Flat Wound	.052	1.32

Set CG26—Medium Gauge

Cat.No	Note	Description	Inch	mm
PL013	E-1st	Plain Steel	.013	.33
PL017	B-2nd	Plain Steel	.017	.43
CG026	G-3rd	Flat Wound	.026	.66
CG035	D-4th	Flat Wound	.035	.89
CG045	A-5th	Flat Wound	.045	1.14
CG056	E-6th	Flat Wound	.056	1.42

Classical Guitar

D'Addario Pro-Arte®

Set J44—Extra Hard Tension

Cat.No.	Note	Description	Inch	mm
J4401	E-1st	Clear Nylon	029	74
J4402	B-2nd	Clear Nylon	033	84
J4403	G-3rd	Clear Nylon	041	1.04
J4404	D-4th	Silverplated	030	76
J4405	A-5th	Silverplated	036	91
J4406	E-6th	Silverplated	045	1.14

Set J45—Normal Tension

Cat.No.	Note	Description	Inch	mm
J4501	E-1st	Clear Nylon	028	71
J4502	B-2nd	Clear Nylon	032	81
J4503	G-3rd	Clear Nylon	040	1.02
J4504	D-4th	Silverplated	029	74
J4505	A-5th	Silverplated	034	86
J4506	E-6th	Silverplated	043	1.09

Set J46—Hard Tension

Cat.No.	Note	Description	Inch	mm
J4601	E-1st	Clear Nylon	028	71
J4602	B-2nd	Clear Nylon	032	81
J4603	G-3rd	Clear Nylon	040	1.02
J4604	D-4th	Silverplated	030	76
J4605	A-5th	Silverplated	036	91
J4606	E-6th	Silverplated	044	1.12

Set J47—Normal Tension

Cat.No.	Note	Description	Inch	mm
J4701	E-1st	Clear Nylon	028	71
J4702	B-2nd	Clear Nylon	032	81
J4703	G-3rd	Clear Nylon	040	1.02
J4704	D-4th	Gold(Bronze)	029	74
J4705	A-5th	Gold(Bronze)	035	89
J4706	E-6th	Gold(Bronze)	043	1.09

Set J48—Hard Tension

Cat.No.	Note	Description	Inch	mm
J4801	E-1st	Clear Nylon	028	71
J4802	B-2nd	Clear Nylon	032	81
J4803	G-3rd	Clear Nylon	040	1.02
J4804	D-4th	Gold(Bronze)	030	76
J4805	A-5th	Gold(Bronze)	036	91
J4806	E-6th	Gold(Bronze)	044	1.12

Set J49—Normal Tension

Cat.No.	Note	Description	Inch	mm
J4901	E-1st	Black Nylon	028	71
J4902	B-2nd	Black Nylon	032	81
J4903	G-3rd	Black Nylon	040	1.02
J4904	D-4th	Silverplated	029	74
J4905	A-5th	Silverplated	035	89
J4906	E-6th	Silverplated	043	1.09

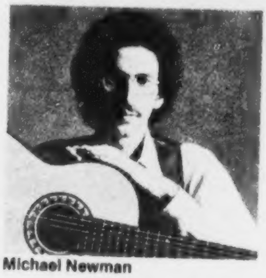
Set J50—Hard Tension

Cat.No.	Note	Description	Inch	mm
J5001	E-1st	Black Nylon	028	71
J5002	B-2nd	Black Nylon	032	81
J5003	G-3rd	Black Nylon	040	1.02
J5004	D-4th	Silverplated	030	76
J5005	A-5th	Silverplated	036	91
J5006	E-6th	Silverplated	044	1.12

David Russell

Benjamin Verdery

Alice Artzt



Michael Newman

Classical Guitar

D'Addario Classic

Set J28—Normal Tension

Cat.No.	Note	Description	Inch	mm
J2801	E-1st	Rectified Nylon	028	71
J2802	B-2nd	Rectified Nylon	032	81
J2803	G-3rd	Rectified Nylon	040	1.02
J2804	D-4th	Sterling Silver	029	74
J2805	A-5th	Sterling Silver	034	86
J2806	E-6th	Sterling Silver	042	1.07

Set J29—Moderate Tension

Cat.No.	Note	Description	Inch	mm
J2901	E-1st	Rectified Nylon	027	69
J2902	B-2nd	Rectified Nylon	031	79
J2903	G-3rd	Rectified Nylon	039	99
J2904	D-4th	Silverplated	028	71
J2905	A-5th	Silverplated	033	84
J2906	E-6th	Silverplated	042	1.07

Set J30—Normal Tension

Cat.No.	Note	Description	Inch	mm
J3001	E-1st	Rectified Nylon	028	71
J3002	B-2nd	Rectified Nylon	032	81
J3003	G-3rd	Rectified Nylon	040	1.02
J3004	D-4th	Silverplated	029	74
J3005	A-5th	Silverplated	035	89
J3006	E-6th	Silverplated	043	1.09

Set J31—Hard Tension

Cat.No.	Note	Description	Inch	mm
J3101	E-1st	Rectified Nylon	029	74
J3102	B-2nd	Rectified Nylon	033	84
J3103	G-3rd	Rectified Nylon	041	1.04
J3104	D-4th	Silverplated	030	76
J3105	A-5th	Silverplated	036	91
J3106	E-6th	Silverplated	044	1.12

Folk Guitar

Set J32—Ball End Nylon

Cat.No.	Note	Description	Inch	mm
BEB028	E-1st	Black Nylon	028	71
BEB032	B-2nd	Black Nylon	032	81
BEB040	G-3rd	Black Nylon	040	1.02
BES031	D-4th	Silverplated	031	79
BES037	A-5th	Silverplated	037	94
BEB045	E-6th	Silverplated	045	1.14

Set J33—Ball End Nylon

Cat.No.	Note	Description	Inch	mm
BEC028	E-1st	Clear Nylon	028	71
BEC032	B-2nd	Clear Nylon	032	81
BEC040	G-3rd	Clear Nylon	040	1.02
BEB031	D-4th	Gold(Bronze)	031	79
BEB037	A-5th	Gold(Bronze)	037	94
BEB045	E-6th	Gold(Bronze)	045	1.14

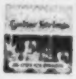
Set J34—Ball End Nylon

Cat.No.	Note	Description	Inch	mm
BEB028	E-1st	Black Nylon	028	71
BEB032	B-2nd	Black Nylon	032	81
BEB040	G-3rd	Black Nylon	040	1.02
BEB031	D-4th	Gold(Bronze)	031	79
BEB037	A-5th	Gold(Bronze)	037	94
BEB045	E-6th	Gold(Bronze)	045	1.14

Set J40—Silk & Steel

Cat.No.	Note	Description	Inch	mm
PL011	E-1st	Plain Steel	011	28
PL014	B-2nd	Plain Steel	014	36
J4003	G-3rd	Silk & Steel	023	58
J4004	D-4th	Silk & Steel	028	71
J4005	A-5th	Silk & Steel	038	97
J4006	E-6th	Silk & Steel	047	1.19

Set J35—12 String Silk & Steel



Cat.No.	Note	Description	Inch	mm
PL011	E-1st	Plain Steel	011	28
PL011	E-2nd	Plain Steel	011	28
PL014	B-3rd	Plain Steel	014	36
PL014	B-4th	Plain Steel	014	36
J3505	G-5th	Silk & Steel	023	58
PL009	G-6th	Plain Steel	009	23
J3507	D-7th	Silk & Steel	028	71
PL014	D-8th	Plain Steel	014	36
J3509	A-9th	Silk & Steel	038	97
PL018	A-10th	Plain Steel	018	46
J3511	E-11th	Silk & Steel	047	1.19
J3512	E-12th	Silk & Steel	028	71

Banjo

Set J60—5 String Light-Nickel Wound

Cat.No.	Note	Description	Inch	mm
LE009	D-1st	Plain Steel	.009	.23
LE010	B-2nd	Plain Steel	.010	.25
LE013	G-3rd	Plain Steel	.013	.33
LE020	C-4th	Nickel	.020w	.51
LE009	G-5th	Plain Steel	.009	.23

Set J61—5 Str. Medium-Nickel Wound

Cat.No.	Note	Description	Inch	mm
LE010	D-1st	Plain Steel	.010	.25
LE012	B-2nd	Plain Steel	.012	.30
LE016	G-3rd	Plain Steel	.016	.41
LE023	C-4th	Nickel	.023w	.58
LE010	G-5th	Plain Steel	.010	.25

Set J63—Tenor Banjo-Nickel Wound

Cat.No.	Note	Description	Inch	mm
LE009	A-1st	Plain Steel	.009	.23
LE016	D-2nd	Plain Steel	.016	.41
LE023	G-3rd	Nickal	.023w	.58
LE030	C-4th	Nickel	.030w	.76

Set J69—5 Str. Bluegrass-Phos. Bronze

Cat.No.	Note	Description	Inch	mm
J6901	D-1st	Plain Steel	.009	.23
J6902	B-2nd	Plain Steel	.011	.28
J6903	G-3rd	Plain Steel	.013	.33
J6904	C-4th	Phosphor	.020w	.51
J6905	G-5th	Plain Steel	.009	.23

Set J69B—5 String Ball End-Bronze

Cat.No.	Note	Description	Inch	mm
J6901B	D-1st	Plain Steel	.009	.23
J6902B	B-2nd	Plain Steel	.011	.28
J6903B	G-3rd	Plain Steel	.013	.33
J6904B	C-4th	Phosphor	.020w	.51
J6905B	G-5th	Plain Steel	.009	.23

Mandolin Family

Set J62—Mandolin-80/20 Bronze

Cat.No.	Note	Description	Inch	mm
J6201	E-1st	(2) Plain Steel	.010	.25
J6202	A-2nd	(2) Plain Steel	.014	.36
J6203	D-3rd	(2) 80/20 Bronze	.024	.61
J6204	G-4th	(2) 80/20 Bronze	.034	.86

Set J67—Mandolin-Acoustic/Electric

Cat.No.	Note	Description	Inch	mm
J6701	E-1st	(2) Plain Steel	.011	.28
J6702	A-2nd	(2) Plain Steel	.014	.36
J6703	D-3rd	(2) Nickel	.025	.64
J6704	G-4th	(2) Nickel	.039	.99

Set J74—Mandolin-Phosphor Bronze

Cat.No.	Note	Description	Inch	mm
J7401	E-1st	(2) Plain Steel	.011	.28
J7402	A-2nd	(2) Plain Steel	.015	.38
J7403	D-3rd	(2) Phosphor	.026	.66
J7404	G-4th	(2) Phosphor	.040	1.02

David Grisman

Mark O'Connor

BLUE ANCHOR

Bert Jansch

Mandolin Family (continued)

Set J76—Mandola Light-Bronze

Cat.No.	Note	Description	Inch	mm
J7601	A-1st	(2) Plain Steel	.014	.36
J7602	D-2nd	(2) Phosphor	.024	.61
J7603	G-3rd	(2) Phosphor	.033	.84
J7604	C-4th	(2) Phosphor	.048	1.22

Set J77—Mandola Medium-Bronze

Cat.No.	Note	Description	Inch	mm
J7701	A-1st	(2) Plain Steel	.016	.41
J7702	D-2nd	(2) Phosphor	.025	.64
J7703	G-3rd	(2) Phosphor	.036	.91
J7704	C-4th	(2) Phosphor	.056	1.42

Set J78—Mandocello-Phosphor Bronze

Cat.No.	Note	Description	Inch	mm
J7801	A-1st	(2) Phosphor Bronze Wound	.022	.56
J7802	D-2nd	(2) Phosphor Bronze Wound	.034	.86
J7803	G-3rd	(2) Phosphor Bronze Wound	.048	1.22
J7804	C-4th	(2) Phosphor Bronze Wound	.074	1.88

Set J79—Mandobass-Copper Coated

Cat.No.	Note	Description	Inch	mm
J7901	G-1st	(2) Copper Coated Steel	.049	1.24
J7902	D-2nd	(2) Copper Coated Steel	.063	1.60
J7903	A-3rd	(2) Copper Coated Steel	.097	2.46
J7904	E-4th	(2) Copper Coated Steel	.130	3.30

Other Sets

Set J64—Dulcimer

Cat.No.	Note	Description	Inch	mm
J6401	1st	Plain Steel	.012	.30
J6402	2nd	Plain Steel	.012	.30
J6403	3rd	Plain Steel	.014	.36
J6404	4th	Nickel Wound	.022w	.56

Set J65—Ukulele-Nylon

Cat.No.	Note	Description	Inch	mm
J6501	B-1st	Clear Nylon	.025	.64
J6502	F#-2nd	Clear Nylon	.032	.81
J6503	D-3rd	Clear Nylon	.036	.91
J6504	A-4th	Clear Nylon	.028	.71

Set J66—Tenor Guitar-80/20 Bronze

Cat.No.	Note	Description	Inch	mm
J6601	E-1st	Plain Steel	.010	.25
J6602	B-2nd	Plain Steel	.014	.36
J6603	G-3rd	Bronze	.022	.56
J6604	D-4th	Bronze	.032	.81

Set J68—Baritone Ukulele-Nylon

Cat.No.	Note	Description	Inch	mm
J6801	E-1st	Clear Nylon	.028	.71
J6802	B-2nd	Clear Nylon	.032	.81
J6803	G-3rd	Silverplated	.030	.76
J6804	D-4th	Silverplated	.035	.89

Electric Bass Guitar

XL® Nickel Round Wound

D'Addario
XL

Set XL220—Super Soft/Long Scale

Cat.No.	Note	Description	Inch	mm
XLB040	G-1st	Nickel Round Wound	.040	1.02
XLB060	D-2nd	Nickel Round Wound	.060	1.52
XLB075	A-3rd	Nickel Round Wound	.075	1.91
XLB095	E-4th	Nickel Round Wound	.095	2.41

D'Addario
XL

Set XL170—Soft Gauge/Long Scale

Cat.No.	Note	Description	Inch	mm
XLB045	G-1st	Nickel Round Wound	.045	1.14
XLB065	D-2nd	Nickel Round Wound	.065	1.65
XLB080	A-3rd	Nickel Round Wound	.080	2.03
XLB100	E-4th	Nickel Round Wound	.100	2.54

D'Addario
XL

Set XL160—Regular Ga./Long Scale

Cat.No.	Note	Description	Inch	mm
XLB050	G-1st	Nickel Round Wound	.050	1.27
XLB070	D-2nd	Nickel Round Wound	.070	1.78
XLB085	A-3rd	Nickel Round Wound	.085	2.16
XLB105	E-4th	Nickel Round Wound	.105	2.67

D'Addario
XL

Set XL230—Heavy Ga./Long Scale

Cat.No.	Note	Description	Inch	mm
XLB055	G-1st	Nickel Round Wound	.055	1.40
XLB075	D-2nd	Nickel Round Wound	.075	1.91
XLB090	A-3rd	Nickel Round Wound	.090	2.29
XLB110	E-4th	Nickel Round Wound	.110	2.79

D'Addario
XL

Set XL170S—Soft Ga./Short Scale

Cat.No.	Note	Description	Inch	mm
XB045S	G-1st	Nickel Round Wound	.045	1.14
XB065S	D-2nd	Nickel Round Wound	.065	1.65
XB080S	A-3rd	Nickel Round Wound	.080	2.03
XB100S	E-4th	Nickel Round Wound	.100	2.54

D'Addario
XL

Set XL170M—Soft Ga./Med. Scale

Cat.No.	Note	Description	Inch	mm
XB045M	G-1st	Nickel Round Wound	.045	1.14
XB065M	D-2nd	Nickel Round Wound	.065	1.65
XB080M	A-3rd	Nickel Round Wound	.080	2.03
XB100M	E-4th	Nickel Round Wound	.100	2.54

D'Addario
XL

Set XL280—Piccolo

Cat.No.	Note	Description	Inch	mm
XLB020	G-1st	Plain Steel	.020	.51
XLB032	D-2nd	Nickel Round Wound	.032	.81
XLB042	A-3rd	Nickel Round Wound	.042	1.07
XLB052	E-4th	Nickel Round Wound	.052	1.32

D'Addario
XL8

Set XL860—8 String Regular Gauge

Cat.No.	Note	Description	Inch	mm
XLB050	G-1st	Nickel	.050	1.27
XLB018	G-2nd	Plain Steel (octave)	.018	.46
XLB070	D-3rd	Nickel	.070	1.78
XLB028	D-4th	Nickel (octave)	.028	.71
XLB085	A-5th	Nickel	.085	2.16
XLB040	A-6th	Nickel (octave)	.040	1.02
XLB105	E-7th	Nickel	.105	2.67
XLB050	E-8th	Nickel (octave)	.050	1.27

Electric Bass Guitar

XL® Reds Copper Coated Wound

D'Addario
XL

Set R360—Soft Ga./Long Scale

Cat.No.	Note	Description	Inch	mm
RB045	G-1st	Copper Coated Steel	.045	1.14
RB065	D-2nd	Copper Coated Steel	.065	1.65
RB080	A-3rd	Copper Coated Steel	.080	2.03
RB100	E-4th	Copper Coated Steel	.100	2.54

D'Addario
XL

Set R370—Regular Ga./Long Scale

Cat.No.	Note	Description	Inch	mm
RB050	G-1st	Copper Coated Steel	.050	1.27
RB070	D-2nd	Copper Coated Steel	.070	1.78
RB085	A-3rd	Copper Coated Steel	.085	2.16
RB105	E-4th	Copper Coated Steel	.105	2.67

Electric Bass Guitar

D'Addario Half Round® Series II-Stainless Steel

DADDARIO
HALF ROUND

Set S-HR70—Super Soft/Long Scale

Cat.No.	Note	Description	Inch	mm
SHR040	G-1st	Stainless Steel	.040	1.02
SHR060	D-2nd	Stainless Steel	.060	1.52
SHR075	A-3rd	Stainless Steel	.075	1.91
SHR095	E-4th	Stainless Steel	.095	2.41

DADDARIO
HALF ROUND
SERIES II

Set S-HR71—Soft Gauge/Long Scale

Cat.No.	Note	Description	Inch	mm
SHR045	G-1st	Stainless Steel	.045	1.14
SHR065	D-2nd	Stainless Steel	.065	1.65
SHR080	A-3rd	Stainless Steel	.080	2.03
SHR100	E-4th	Stainless Steel	.100	2.54

DADDARIO
HALF ROUND
ELECTRIC BASS STRINGS

Set S-HR72—Regular/Long Scale

Cat.No.	Note	Description	Inch	mm
SHR050	G-1st	Stainless Steel	.050	1.27
SHR070	D-2nd	Stainless Steel	.070	1.78
SHR085	A-3rd	Stainless Steel	.085	2.16
SHR105	E-4th	Stainless Steel	.105	2.67

DADDARIO
HALF ROUND
ELECTRIC BASS STRINGS

Set S-HR73—Heavy Ga./Long Scale

Cat.No.	Note	Description	Inch	mm
SHR055	G-1st	Stainless Steel	.055	1.40
SHR075	D-2nd	Stainless Steel	.075	1.91
SHR090	A-3rd	Stainless Steel	.090	2.29
SHR110	E-4th	Stainless Steel	.110	2.79

DADDARIO
HALF ROUND
ELECTRIC BASS STRINGS

Set S-HR71S—Soft Ga./Short Scale

Cat.No.	Note	Description	Inch	mm
SH045S	G-1st	Stainless Steel	.045	1.14
SH065S	D-2nd	Stainless Steel	.065	1.65
SH080S	A-3rd	Stainless Steel	.080	2.03
SH100S	E-4th	Stainless Steel	.100	2.54

DADDARIO
HALF ROUND

Set S-HR71M—Soft Ga./Med. Scale

Cat.No.	Note	Description	Inch	mm
SH045M	G-1st	Stainless Steel	.045	1.14
SH065M	D-2nd	Stainless Steel	.065	1.65
SH080M	A-3rd	Stainless Steel	.080	2.03
SH100M	E-4th	Stainless Steel	.100	2.54

Electric Bass Guitar
D'Addario Half Round®
Pure Nickel Wound (original)

Set N-HR70—Super Soft/Long Scale

Cat.No.	Note	Description	inch	mm
NHR040	G-1st	Pure Nickel	040	1.02
NHR060	D-2nd	Pure Nickel	060	1.52
NHR075	A-3rd	Pure Nickel	075	1.91
NHR095	E-4th	Pure Nickel	095	2.41

Set N-HR71—Soft Ga./Long Scale

Cat.No	Note	Description	inch	mm
NHR045	G-1st	Pure Nickel	045	1.14
NHR065	D-2nd	Pure Nickel	065	1.65
NHR080	A-3rd	Pure Nickel	.080	2.03
NHR100	E-4th	Pure Nickel	100	2.54

Set N-HR72—Regular/Long Scale

Cat.No	Note	Description	inch	mm
NHR050	G-1st	Pure Nickel	050	1.27
NHR070	D-2nd	Pure Nickel	070	1.78
NHR085	A-3rd	Pure Nickel	085	2.16
NHR105	E-4th	Pure Nickel	105	2.67

Set N-HR73—Heavy Ga./Long Scale

Cat.No	Note	Description	inch	mm
NHR055	G-1st	Pure Nickel	055	1.40
NHR075	D-2nd	Pure Nickel	075	1.91
NHR090	A-3rd	Pure Nickel	090	2.29
NHR110	E-4th	Pure Nickel	110	2.79

Set N-HR71S—Soft Ga./Short Scale

Cat.No.	Note	Description	inch	mm
NH045S	G-1st	Pure Nickel	045	1.14
NH065S	D-2nd	Pure Nickel	065	1.65
NH080S	A-3rd	Pure Nickel	080	2.03
NH100S	E-4th	Pure Nickel	100	2.54

Set N-HR71M—Soft Ga./Med. Scale

Cat.No.	Note	Description	inch	mm
NH045M	G-1st	Pure Nickel	045	1.14
NH065M	D-2nd	Pure Nickel	065	1.65
NH080M	A-3rd	Pure Nickel	080	2.03
NH100M	E-4th	Pure Nickel	100	2.54

Electric Bass Guitar
XLS® Stainless Steel Round Wound

Set XLS550—Super Soft/Long Scale

Cat.No.	Note	Description	inch	mm
XLS040	G-1st	Stainless Round Wound	040	1.02
XLS060	D-2nd	Stainless Round Wound	060	1.52
XLS075	A-3rd	Stainless Round Wound	075	1.91
XLS095	E-4th	Stainless Round Wound	095	2.41

Set XLS560—Soft Gauge/Long Scale

Cat.No.	Note	Description	inch	mm
XLS045	G-1st	Stainless Round Wound	045	1.14
XLS065	D-2nd	Stainless Round Wound	.065	1.65
XLS080	A-3rd	Stainless Round Wound	080	2.03
XLS100	E-4th	Stainless Round Wound	100	2.54

Set XLS570—Regular/Long Scale

Cat.No.	Note	Description	inch	mm
XLS050	G-1st	Stainless Round Wound	.050	1.27
XLS070	D-2nd	Stainless Round Wound	.070	1.78
XLS085	A-3rd	Stainless Round Wound	085	2.16
XLS105	E-4th	Stainless Round Wound	.105	2.67

Electric Bass Guitar
XLS® Stainless Steel (cont.)

Set XLS580—Heavy Ga./Long Scale

Cat.No.	Note	Description	inch	mm
XLS055	G-1st	Stainless Round Wound	055	1.40
XLS075	D-2nd	Stainless Round Wound	075	1.91
XLS090	A-3rd	Stainless Round Wound	090	2.29
XLS110	E-4th	Stainless Round Wound	110	2.79

Set XLS560S—Soft Ga./Short Scale

Cat.No	Note	Description	inch	mm
XS045S	G-1st	Stainless Round Wound	045	1.14
XS065S	D-2nd	Stainless Round Wound	065	1.65
XS080S	A-3rd	Stainless Round Wound	080	2.03
XS100S	E-4th	Stainless Round Wound	100	2.54

Set XLS560M—Soft Ga./Med. Scale

Cat.No.	Note	Description	inch	mm
XS045M	G-1st	Stainless Round Wound	045	1.14
XS065M	D-2nd	Stainless Round Wound	065	1.65
XS080M	A-3rd	Stainless Round Wound	080	2.03
XS100M	E-4th	Stainless Round Wound	100	2.54

Electric Bass Guitar
D'Addario Chromes® Flat Wound

Set CB80—Super Soft/Long Scale

Cat.No.	Note	Description	inch	mm
CB040	G-1st	Flat Wound	040	1.02
CB060	D-2nd	Flat Wound	060	1.52
CB075	A-3rd	Flat Wound	.075	1.91
CB095	E-4th	Flat Wound	095	2.41

Set CB81—Soft Gauge/Long Scale

Cat.No.	Note	Description	inch	mm
CB045	G-1st	Flat Wound	.045	1.14
CB065	D-2nd	Flat Wound	.065	1.65
CB080	A-3rd	Flat Wound	080	2.03
CB100	E-4th	Flat Wound	100	2.54

Set CB82—Regular Ga./Long Scale

Cat.No.	Note	Description	inch	mm
CB050	G-1st	Flat Wound	050	1.27
CB070	D-2nd	Flat Wound	070	1.78
CB085	A-3rd	Flat Wound	.085	2.16
CB105	E-4th	Flat Wound	.105	2.67

Set CB83—Heavy Ga./Long Scale

Cat.No.	Note	Description	inch	mm
CB055	G-1st	Flat Wound	.055	1.40
CB075	D-2nd	Flat Wound	.075	1.91
CB090	A-3rd	Flat Wound	090	2.29
CB110	E-4th	Flat Wound	110	2.79

Set CB81S—Soft Ga./Short Scale

Cat.No.	Note	Description	inch	mm
CB045S	G-1st	Flat Wound	045	1.14
CB065S	D-2nd	Flat Wound	065	1.65
CB080S	A-3rd	Flat Wound	.080	2.03
CB100S	E-4th	Flat Wound	100	2.54

Set CB81M—Soft Ga./Med. Scale

Cat.No.	Note	Description	inch	mm
CB045M	G-1st	Flat Wound	045	1.14
CB065M	D-2nd	Flat Wound	065	1.65
CB080M	A-3rd	Flat Wound	080	2.03
CB100M	E-4th	Flat Wound	100	2.54

D'Addario Gauged Single Strings

Listed below are all the D'Addario single strings that are sold by gauge or diameter. These include the same strings that are found in many of our most popular sets, but also include diameters that may not be found in our stock or catalog sets. This wide variety of string gauges offers the discriminating guitarist the opportunity to select gauge combinations that would otherwise be unavailable to him.

This system also makes it easy for the dealer to match almost any string a customer needs to replace with a D'Addario string. The strings listed below are compatible with all the major brands of strings sold in the U.S.A. and abroad.

Special assortment systems are available to dealers who wish to stock the complete gauge selection of any of the types of strings listed below, e.g. Plain Steel, Phosphor Bronze, etc. Dealers should consult the supplemental dealer sales planner catalog for details.

Acoustic or Electric Guitar

Lock Twist Plain Steel

Cat.No.	Description	Inch	mm
PL007	Plain Steel	.007	.18
PL008	Plain Steel	.008	.20
PL0085	Plain Steel	.0085	.22
PL009	Plain Steel	.009	.23
PL0095	Plain Steel	.0095	.24
PL010	Plain Steel	.010	.25
PL0105	Plain Steel	.0105	.27
PL011	Plain Steel	.011	.28
PL0115	Plain Steel	.0115	.29
PL012	Plain Steel	.012	.30
PL013	Plain Steel	.013	.33
PL014	Plain Steel	.014	.36
PL015	Plain Steel	.015	.38
PL016	Plain Steel	.016	.41
PL017	Plain Steel	.017	.43
PL018	Plain Steel	.018	.46
PL019	Plain Steel	.019	.48
PL020	Plain Steel	.020	.51
PL022	Plain Steel	.022	.56
PL024	Plain Steel	.024	.61
PL026	Plain Steel	.026	.66

Acoustic Guitar

Phosphor Bronze

Cat.No.	Description	Inch	mm
PB020	Phosphor Bronze	.020	.51
PB021	Phosphor Bronze	.021	.53
PB022	Phosphor Bronze	.022	.56
PB023	Phosphor Bronze	.023	.58
PB024	Phosphor Bronze	.024	.61
PB025	Phosphor Bronze	.025	.64
PB026	Phosphor Bronze	.026	.66
PB027	Phosphor Bronze	.027	.69
PB029	Phosphor Bronze	.029	.74
PB030	Phosphor Bronze	.030	.76
PB032	Phosphor Bronze	.032	.81
PB034	Phosphor Bronze	.034	.86
PB035	Phosphor Bronze	.035	.89
PB036	Phosphor Bronze	.036	.91
PB039	Phosphor Bronze	.039	.99
PB042	Phosphor Bronze	.042	1.07
PB045	Phosphor Bronze	.045	1.14
PB047	Phosphor Bronze	.047	1.19
PB049	Phosphor Bronze	.049	1.24
PB052	Phosphor Bronze	.052	1.32
PB053	Phosphor Bronze	.053	1.35
PB056	Phosphor Bronze	.056	1.42
PB059	Phosphor Bronze	.059	1.50

Acoustic Guitar

80/20 Bronze Wound

Cat.No.	Description	Inch	mm
BW020	80/20 Bronze	.020	.51
BW021	80/20 Bronze	.021	.53
BW022	80/20 Bronze	.022	.56
BW023	80/20 Bronze	.023	.58
BW024	80/20 Bronze	.024	.61
BW025	80/20 Bronze	.025	.64
BW026	80/20 Bronze	.026	.66
BW027	80/20 Bronze	.027	.69
BW029	80/20 Bronze	.029	.74
BW030	80/20 Bronze	.030	.76
BW032	80/20 Bronze	.032	.81
BW034	80/20 Bronze	.034	.86
BW035	80/20 Bronze	.035	.89
BW036	80/20 Bronze	.036	.91
BW039	80/20 Bronze	.039	.99
BW042	80/20 Bronze	.042	1.07
BW045	80/20 Bronze	.045	1.14
BW047	80/20 Bronze	.047	1.19
BW049	80/20 Bronze	.049	1.24
BW052	80/20 Bronze	.052	1.32
BW053	80/20 Bronze	.053	1.35
BW056	80/20 Bronze	.056	1.42
BW059	80/20 Bronze	.059	1.50

Electric Guitar

XL® Nickel Round Wound

Cat.No.	Description	Inch	mm
NW017	Nickel Wound	.017	.43
NW018	Nickel Wound	.018	.46
NW019	Nickel Wound	.019	.48
NW020	Nickel Wound	.020	.51
NW021	Nickel Wound	.021	.53
NW022	Nickel Wound	.022	.56
NW024	Nickel Wound	.024	.61
NW026	Nickel Wound	.026	.66
NW028	Nickel Wound	.028	.71
NW030	Nickel Wound	.030	.76
NW032	Nickel Wound	.032	.81
NW034	Nickel Wound	.034	.86
NW036	Nickel Wound	.036	.91
NW038	Nickel Wound	.038	.97
NW039	Nickel Wound	.039	.99
NW042	Nickel Wound	.042	1.07
NW044	Nickel Wound	.044	1.12
NW046	Nickel Wound	.046	1.17
NW048	Nickel Wound	.048	1.22
NW049	Nickel Wound	.049	1.24
NW052	Nickel Wound	.052	1.32
NW056	Nickel Wound	.056	1.42
NW059	Nickel Wound	.059	1.50
NW060	Nickel Wound	.060	1.52
NW062	Nickel Wound	.062	1.57
NW064	Nickel Wound	.064	1.63
NW066	Nickel Wound	.066	1.68
NW068	Nickel Wound	.068	1.73
NW070	Nickel Wound	.070	1.78
NW072	Nickel Wound	.072	1.83
NW074	Nickel Wound	.074	1.88
NW080	Nickel Wound	.080	2.03

Electric Guitar

D'Addario Half Round® Series II · Stainless Steel

Cat.No.	Description	Inch	mm
HRG022	Stainless Steel	.022	.56
HRG024	Stainless Steel	.024	.61
HRG026	Stainless Steel	.026	.66
HRG030	Stainless Steel	.030	.76
HRG032	Stainless Steel	.032	.81
HRG036	Stainless Steel	.036	.91
HRG039	Stainless Steel	.039	.99
HRG042	Stainless Steel	.042	1.07
HRG046	Stainless Steel	.046	1.17
HRG052	Stainless Steel	.052	1.32
HRG056	Stainless Steel	.056	1.42

Electric Guitar

D'Addario Chromes® Stainless Flat Wound

Cat.No.	Description	Inch	mm
CG022	Flat Wound	.022	.56
CG024	Flat Wound	.024	.61
CG026	Flat Wound	.026	.66
CG030	Flat Wound	.030	.76
CG032	Flat Wound	.032	.81
CG035	Flat Wound	.035	.89
CG040	Flat Wound	.040	1.02
CG042	Flat Wound	.042	1.07
CG045	Flat Wound	.045	1.14
CG050	Flat Wound	.050	1.27
CG052	Flat Wound	.052	1.32
CG056	Flat Wound	.056	1.42

Classical Guitar

Nylon Gauged Singles

Rectified Nylon-Natural Color

Cat.No.	Description	Inch	mm
NYL018	Clear Nylon	.018	.46
NYL019	Clear Nylon	.019	.48
NYL020	Clear Nylon	.020	.51
NYL021	Clear Nylon	.021	.53
NYL022	Clear Nylon	.022	.56
NYL024	Clear Nylon	.024	.61
NYL027	Clear Nylon	.027	.69
NYL028	Clear Nylon	.028	.71
NYL029	Clear Nylon	.029	.74
NYL030	Clear Nylon	.030	.76
NYL031	Clear Nylon	.031	.79
NYL032	Clear Nylon	.032	.81
NYL033	Clear Nylon	.033	.84
NYL034	Clear Nylon	.034	.86
NYL038	Clear Nylon	.038	.97
NYL039	Clear Nylon	.039	.99
NYL040	Clear Nylon	.040	1.02
NYL041	Clear Nylon	.041	1.04

Silverplated Wound on Nylon

Cat.No.	Description	Inch	mm
NYL018w	Silverplated	.018	.46
NYL019w	Silverplated	.019	.48
NYL020w	Silverplated	.020	.51
NYL021w	Silverplated	.021	.53
NYL023w	Silverplated	.023	.58
NYL025w	Silverplated	.025	.64
NYL028w	Silverplated	.028	.71
NYL030w	Silverplated	.030	.76
NYL031w	Silverplated	.031	.79
NYL033w	Silverplated	.033	.84
NYL034w	Silverplated	.034	.86
NYL035w	Silverplated	.035	.89
NYL036w	Silverplated	.036	.91
NYL040w	Silverplated	.040	1.02
NYL041w	Silverplated	.041	1.04
NYL043w	Silverplated	.043	1.09
NYL045w	Silverplated	.045	1.14

Loop End Singles

All strings are 46" long. Excellent for acoustic or electric mandolin, banjo, dulcimers etc.

Plain Steel

Cat.No.	Description	Inch	mm
LE008	Plain Steel	.008	.20
LE009	Plain Steel	.009	.23
LE010	Plain Steel	.010	.25
LE011	Plain Steel	.011	.28
LE012	Plain Steel	.012	.30
LE013	Plain Steel	.013	.33
LE014	Plain Steel	.014	.36
LE015	Plain Steel	.015	.38
LE016	Plain Steel	.016	.41
LE017	Plain Steel	.017	.43
LE018	Plain Steel	.018	.46

Nickel Wound

Cat.No.	Description	Inch	mm
LE018w	Nickel Wound	.018	.46
LE020	Nickel Wound	.020	.51
LE022	Nickel Wound	.022	.56
LE023	Nickel Wound	.023	.58
LE024	Nickel Wound	.024	.61
LE026	Nickel Wound	.026	.66
LE028	Nickel Wound	.028	.71
LE030	Nickel Wound	.030	.76
LE032	Nickel Wound	.032	.81
LE034	Nickel Wound	.034	.86
LE036	Nickel Wound	.036	.91
LE038	Nickel Wound	.038	.97
LE040	Nickel Wound	.040	1.02

Electric Bass

XL® Nickel Round Wound Long Scale

Cat.No.	Description	Inch	mm
XLB018p	Plain Steel	.018	.46
XLB020p	Plain Steel	.020	.51
XLB028w	Nickel Wound	.028	.71
XLB032	Nickel Wound	.032	.81
XLB040	Nickel Wound	.040	1.02
XLB042	Nickel Wound	.042	1.07
XLB045	Nickel Wound	.045	1.14
XLB050	Nickel Wound	.050	1.27
XLB052	Nickel Wound	.052	1.32
XLB055	Nickel Wound	.055	1.40
XLB060	Nickel Wound	.060	1.52
XLB065	Nickel Wound	.065	1.65
XLB070	Nickel Wound	.070	1.78
XLB075	Nickel Wound	.075	1.91
XLB080	Nickel Wound	.080	2.03
XLB085	Nickel Wound	.085	2.16
XLB090	Nickel Wound	.090	2.29
XLB095	Nickel Wound	.095	2.41
XLB100	Nickel Wound	.100	2.54
XLB105	Nickel Wound	.105	2.67
XLB110	Nickel Wound	.110	2.79

Electric Bass

XL® Reds-Copper Coated Round Wound-Long Scale

Cat.No.	Description	Inch	mm
RB045	Copper Coated	.045	1.14
RB050	Copper Coated	.050	1.27
RB065	Copper Coated	.065	1.65
RB070	Copper Coated	.070	1.78
RB080	Copper Coated	.080	2.03
RB085	Copper Coated	.085	2.16
RB100	Copper Coated	.100	2.54
RB105	Copper Coated	.105	2.67

Electric Bass

D'Addario Half Round® Series II-Stainless Steel

Cat.No.	Description	Inch	mm
SHRB040	Stainless Steel	.040	1.02
SHRB045	Stainless Steel	.045	1.14
SHRB050	Stainless Steel	.050	1.27
SHRB055	Stainless Steel	.055	1.40
SHRB060	Stainless Steel	.060	1.52
SHRB065	Stainless Steel	.065	1.65
SHRB070	Stainless Steel	.070	1.78
SHRB075	Stainless Steel	.075	1.91
SHRB080	Stainless Steel	.080	2.03
SHRB085	Stainless Steel	.085	2.16
SHRB090	Stainless Steel	.090	2.29
SHRB095	Stainless Steel	.095	2.41
SHRB100	Stainless Steel	.100	2.54
SHRB105	Stainless Steel	.105	2.67
SHRB110	Stainless Steel	.110	2.79

Electric Bass

D'Addario Half Round® Pure Nickel-(original)

Cat.No.	Description	Inch	mm
NHRB040	Pure Nickel	.040	1.02
NHRB045	Pure Nickel	.045	1.14
NHRB050	Pure Nickel	.050	1.27
NHRB055	Pure Nickel	.055	1.40
NHRB060	Pure Nickel	.060	1.52
NHRB065	Pure Nickel	.065	1.65
NHRB070	Pure Nickel	.070	1.78
NHRB075	Pure Nickel	.075	1.91
NHRB080	Pure Nickel	.080	2.03
NHRB085	Pure Nickel	.085	2.16
NHRB090	Pure Nickel	.090	2.29
NHRB095	Pure Nickel	.095	2.41
NHRB100	Pure Nickel	.100	2.54
NHRB105	Pure Nickel	.105	2.67
NHRB110	Pure Nickel	.110	2.79

D'ADDARIO
Mandola
STRINGS
J76 - One Set of 8 Strings
Phosphor Bronze - Light Gauge
D'ADDARIO
HALF ROUND
ELECTRIC BASS STRINGS
Precision Ground Pure Nickel
One Set N-HR72
D'Addario
Pro-Arté
Classical Guitar
J47 • Normal Tension
Gold Alloy Wound
D'Addario
XLS
ELECTRIC GUITAR STRINGS
XL8600
D'Addario
BLACK TARBOS
GOLD ALLOY BASSES
D'ADDARIO
5 STRING
BANJO
STRINGS
J60 - One Set of 5 Strings
Nickel Wound - Light Gauge

Packaging

Sets:

Bass guitar sets are packed in 5's.
All other sets are packed in 10's.

Single Strings (replacements)

Plain steel strings packed 10 per plastic bag. All other strings 5 per plastic bag.

All D'Addario Strings are made in the USA under the direct supervision of the D'Addario Family.

Specifications subject to change without notice.

Distributed by:

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D'Addario

E. FARMINGDALE, NY 11735 USA

As Seen In
Guitar
PLAYER
February 1976

Meet The D'Addarios
GUITAR STRINGS
From A Perspective Of Eight Generations

By Stefan Grossman

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Meet The D
GUITAR S
From A Perspective C

By Stefan Gr

John D'Addario's family has been in the string business for a long time – eight generations, to be exact. The family began producing strings in a small Italian town called Salle, in the province of Pescara. This town, high in the mountains off the Adriatic Sea, was the breeding ground for many of the world's finest string makers.

John's father, Charles, came to America in 1909. At first, he imported strings from Italy and sold them by calling individually on music shops. In 1916, after the start of World War I, he began making strings in Long Island City, since it was no longer possible to import them. He called his business Charles D'Addario Company and specialized in strings for the violin family of instruments.

His brand labels were La Rita and Puccini, and he also produced many private label strings. Brand names were not so important at that time, and a good portion of Charles D'Addario's strings were sold in plain, no-label packages. He continued to call on music dealers and sell strings from his sample case - something like on-the-spot delivery - developing a growing reputation.

In those days, National Music Strings Company (Black Diamond) had a monopoly on the guitar string market, while Gibson began producing their own strings at about the same time. The small shops, like D'Addario's, were insignificant at first, since they specialized in the violin string family. Today, the number of companies which actually manufacture their own strings is about twelve, among them Darco Strings, E & O Mari, Augustine, Gibson, Squire, G.H.S., National Strings, Mapes, and Aranjuez.

In the family tradition, John D'Addario joined his father's business in 1935, right after finishing high school. He mastered the skills involved in making violin, viola, cello, and bass strings, and also became very interested in learning about steel strings (the company produced only gut and wound-on-gut strings at that time).

In 1938, C. D'Addario & Son, as the firm was now called, began making guitar strings. Because of the high calibre of workmanship required to produce fiddle strings, applying these skills to guitar strings enabled them to create a high quality product. The company worked first with John D'Angelico, who had just begun to build his first guitar.

Nick (R) with son Philip. Nick, the fifth generation of string makers, died in Italy in 1929

From there, D'Addario's reputation quickly spread. They were the first manufacturer to offer guitarists a choice of light, medium, or heavy gauge strings. In 1953, John D'Addario, along with three others, started the Archaic Music String Corporation, and John divided his time between C. D'Addario and Archaic. After Charles D'Addario's retirement, the assets of the two companies were consolidated and the operation was renamed Darco Music Strings, Inc. John's son, John Jr., joined this new venture, and in 1970 the business was acquired by the C. F. Martin Organisation. However, John and his son found corporate policies and structure different than they were accustomed to and decided to resign.

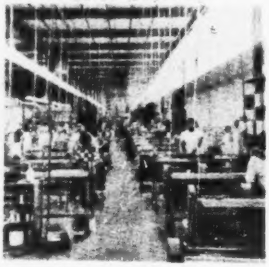
In September, 1974, John and his two sons, John Jr. and James, began producing strings as J. D'Addario & Company, Inc. John Jr. and James represent the family's eighth generation of string makers. Below, John Sr. talks about the craft of making strings.

* * * *

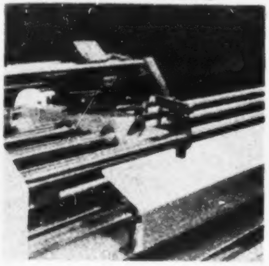
When you began making guitar strings, did you bring any new thoughts and concepts into the development of

Three generations of D'Addario string makers: (L–

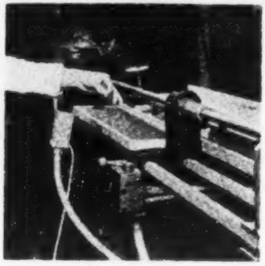
String winding department.



Feeding the wire automatically.



Hand-winding a string.



et The D'Addarios

AR STRINGS

tive Of Eight Generations

By Stefan Grossman

John Sr. (L) with Charles in 1936.

g makers: (L–R) John Jr., Charles, John Sr., and James.

materials being used?

For sure. In those days, the most popular strings being used were wound with silver-plated copper wire. Black Diamond and Beli brands were the largest sellers. They were available in one standard gauge. Bronze and monel were just coming into use. With the guitar being used in the big band era, and amplification not yet really developed, a strong penetrating sounding string was needed. Our experimenting led us to believe that the bronze high copper content wire was the material to be used. We felt that this metal produced the most brilliant sound. The yellow 80/20 brass and the red 90/10 bronze had similar qualities. Later, we chose the yellow 80/20 brass because it was cosmetically different than what other manufacturers used. With the help of the metallurgists at the wire mills, new developments on this material made it ideal for our use. For many years we were more or less the sole user of 80/20 brass, but it has now become a standard of the industry. Recent experiments with a phosphor bronze alloy also have been very successful, and we have added this item to our present string line.

Why are you working with phosphor bronze alloys?

We are always seeking to improve our product. Last year, we began experimenting with phosphor bronze, and after going back and forth to the mill with different suggestions, we hit upon the alloy we are using in our line today. The phosphor bronze we use contains phosphorous (about 8%). This material is very strong and enables us to apply more tension to wrap wire while it is being wound. This produces a string with longer life.

What's the difference in sound quality?

Very little difference if the 80/20 brass and bronze are of similar temper. To my ear, 80/20 brass sounds slightly brighter than the bronze.

Are you considering changing over completely to phosphor bronze?

We're not changing, we're adding to our line. Now you have a choice between two strings that have slightly different qualities. Some guitarists think phosphor bronze is an improvement and other disagree. Our short experience with phosphor bronze strings has been very encouraging.

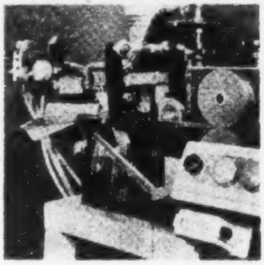
Where do you get the alloys you use?

We buy our wire from six or seven different mills. Each different alloy is the product of years of trial and error and testing. We are not metallurgists. We rely on our suppliers to help us develop the products we need, and they rely heavily on the results of our testing.

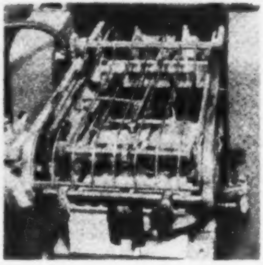
You produce both hand-wound and machine-wound strings. What's the different in the sound quality?

Hand winding consists of manually feeding the wrap wire onto the core of the string. An experienced hand winder can compensate for fluctuations in the manufacture and spooling of the wrap wire. The end result is a very consistent string. In the automatic winding process the wire is fed by a mechanical carriage. Until recently, control of the wire tension and speed of the carriage has been difficult to maintain. We have designed electronic devices that have enabled us to control these variables to a point where there is virtually no difference between the hand-wound and the machine-wound strings. There are some areas, however, where hand winding still excells — for instance, all of our nylon classical strings and silk and steel folk

Attaching ball ends automatically.



Labels being printed in D'Addario plant



New D'Addario facility in Lindenhurst, NY

strings are still hand-wound.

Are you the only string manufacturer using these new electronic controls?

I believe so. Many of the things in our plant today are entirely new to the industry.

What other new innovations are you using to make strings?

As you probably know, we are not only making bronze and brass acoustic strings. We make strings for electric guitar, classical guitar, electric bass, dulcimer, banjo, mandolin, etc. In 1946, we were one of the very first to produce nylon strings for the guitar. We are constantly trying to find new methods to improve the quality. The nylon monofilament which is used for the first three strings on the classic guitar is a product of extrusion. Inherent in this process is a variation in diameter and shape of the finished product. Recently, we have developed a new process to resize and reshape these strings to a much closer tolerance. To give you an example, the raw nylon we receive can vary as much as ±.002". We can process it to a tolerance of ±.0002". The end result is a perfectly round and uniform string all along its length. With this new process we are also able to produce diameters that were not available before.

Is the nylon you get from DuPont standard?

Yes, basically it's the same material used for the fishing line and brush making industries. That doesn't sound very romantic, does it? DuPont is not too interested in the guitar string industry – the volume is small compared to others. For instance, they make nylon in only a few diameters. You can't order any size you want. They offer .028, .032, .036, .040, etc. If you want .039, you can't get it. But, with our new re-sizing and reshaping process, we can produce any diameter to within tolerances of ±.0002". This is a remarkable advantage.

Why was silk originally chosen for the ends of the strings?

Originally, before the introduction of hexagon core wire, it was necessary to secure the wrap wire in some fashion. Along with the crimping of the core wire in several places on the string, we also applied the colored silk wrappings to further insure that the string would not become loose. It was just insurance against a string going dead prematurely. We still apply the silk winding at the ball end of our strings. Often string breakage occurs at the twisted section of the plain steel string, as this is a particular point of stress. We have found that the silk gives the string more support in this area. It's just a mark of quality.

How about the cores? Some people have different types of cores in the strings.

We use a hexagon core and have been doing so for years. The hexagon shape holds the wrap wire securely. Round wire requires crimping where the wrap ends, to secure the winding. This process is not foolproof, and many dead strings may result. Hexagon wire is an assurance that the wrap will not come loose. Its one flaw is that sometimes it's out of shape. In other words, if you took a close-up cross-sectional view of the material, it would be slightly malformed. This is a defect in the manufacturing of the wire itself. The wire is drawn through carbide shaping dies at the mill and when the dies wear out the wire shows it. Fortunately, our staff checks over our raw materials continually. Steel wire is inspected under a high-power microscope at frequent intervals during production. Any poorly shaped material is rejected.

How is the winding secured?

The edges of the hexagon shaped core wire literally grip the wrap wire. Also the right amount of wire tension is necessary to secure the winding. No adhesives or chemicals are used.

Do other manufacturers use hexagon wire in the cores they make?

Yes, but not exclusively. Up until recently there was only one source of supply for hexagon core wire, and during the shortages of 1974 everybody was forced to use round core wire when the hard-to-get hexagon was not available. During this time, we developed another source of supply and were never short of material.

Compare the core system (and the wrap concept) you used before World War II with that used today. Why did you change?

Before the war, very heavy core wire was used in conjunction with a thin wrap. This produced a string with a very shallow flat tone. We experimented with different core and wrap combinations and hit on some that produced a far superior tone, especially on the 5th and 6th strings of the guitar. Continuing our research, we developed a set of specifications still in use today.

I was amazed to find several years ago that all the different brands of strings are actually made by a handful of manufacturers, but they all have different names.

I think we can take credit for making a good share of them. After all, private labeling has been our business for many years. We like the private label business because it increases our volume; therefore, it makes it possible for us to secure our raw materials in larger quantities and at a lower cost.

Can we mention the names of the packages you are now making?

No, I don't think that it would be fair to the people we make strings for – after all, it is a *private* label. But there are a few brands that will not hesitate to mention that we are their source.

What makes a string go dead, besides being played too long?

A string goes dead for several reasons: It could be because an improperly processed core wire has been used; or the winding is not tight enough; or the guitar wasn't properly strung; I could go on and on. With proper care, strings of good quality should last. The brilliant sound that a newly strung guitar produces vanishes in a few days, but it still maintains a good sound. A new set of strings should really ring out. The design of our acoustic strings, with a light diameter core and heavy wrap, gives up a little longevity but produces a really brilliant sound initially.

So, with a heavier core and lighter wrap, the string might last longer, but would not have the brilliant sound?

Right, you would have the same poor sound forever. You see, when a good player strings his guitar, he is looking for the sound a good set of new strings should give. He doesn't care what happens tomorrow. Today is what he is concerned with. A performer loves to be assured that when he puts on a new set of strings for that show tonight, his guitar is going to ring out with good sound. He doesn't care after it's all over. It's only a set of strings. He can replace them.

How about boiling strings after they are used. Do you think that can give them life?

I don't recommend this, and I have no reason to believe it would be of any help.

Is it possible to, and does anyone, recycle strings?

To our knowledge, no. It would present a very big problem as the wrap wires, which are usually of copper-based alloys, do have a scrap value, while the steel core wire does not. Probably, it would cost more than the scrap value to attempt to separate the material.

What effect would an oil crisis have on your nylon division?

Not a great effect. Our usage of nylon material is really minimal in proportion to the amounts produced.

How many feet of string do you produce a day?

We don't manufacture strings in continuous lengths, each string is made individually. At present our facility produces approximately 10,000 sets of strings per day. If you calculate the average length of a string to be 39" and the fact that there are six strings to each set, it would be about 195,000 feet per day.

Senator D'AMATO. Well, let me say that I think that your experience in terms of how the proper leveraging and packaging of the various financial components, in the fact of strict controls and a bank that doesn't just shovel money out, a financial institution that insists upon the highest standards, is laudable. Projects like yours go a long way toward alleviating much of the economic distress that we have today by creating new jobs and retaining them, also.

Do you have any objection, Don, to that regulation or rule or standard operating procedure, whichever it comes under, by SBA which says that only the creation of new jobs, as opposed to the retention of existing jobs will be considered? Do you take objection to that?

Mr. GALLAGHER. I think both should be accounted for.

Senator D'AMATO. In other words, you feel that it is unduly restrictive.

Mr. GALLAGHER. Yes.

Senator D'AMATO. What if a place is going to close or move because it cannot expand reasonably?

Mr. GALLAGHER. You see, Senator, the thing is that for someone to sit behind a desk, here or wherever, and take these things up—you have to get out and meet with the businessmen. I mean, each case is different. We have financed many projects that may have gone out of business. You just cannot set these operating procedures, and what Steve Gurian was saying and the other gentlemen here is that we know what we are doing; give us more authority and let's cut the red tape at the SBA because these things drag on for months and months. A lot of people are from banks and insurance companies. We know what we are doing.

On the other side of the coin, we are approving unsecured loans to these companies, so we know them intimately. Why should we have to go through this whole routine, and at the end of this, where we have a first mortgage set up for JDA, and we go to SBA and wait 4 or 5 months? It is ridiculous.

Senator D'AMATO. What about the recent experience with applications in our region? Has there been an improvement or have the applications languished? Is it more difficult or is it easier or what?

Mr. GALLAGHER. I think Steve Gurian can answer that better.

Senator D'AMATO. Steve, would you come on up here?

Mr. GALLAGHER. Once we get a project on new construction, we can usually put the mortgage together within 3 weeks, 3 to 4 weeks on the outside, the commitment.

Senator D'AMATO. What is your experience, Steve? Has the regional office been improving, languishing, or what?

Mr. GURIAN. The answer is yes, it has been improving and slowly. As was stated many times, differences in interpretation of the SOP exists between regions, between districts, and even within the districts, between personnel that slows up the procedures.

Senator D'AMATO. Well, I do not want to get into a general discussion about the region. Let's say that you submit an application. Whom do you submit it to?

Mr. GURIAN. We submit it to the district.

Senator D'AMATO. Where is that?

Mr. GURIAN. The district is at the Federal Plaza in New York.

Senator D'AMATO. 26 Federal Plaza?

Mr. GURIAN. 26 Federal Plaza. A loan officer is assigned, and that loan officer will review it in accordance with the SOP's.

Senator D'AMATO. Well, that is the law.

Mr. GURIAN. That is the law, right.

Senator D'AMATO. Now, how long does it take before he gives you his okay or turn-down, on the average?

Mr. GURIAN. Well, average, I would say it is in excess of 3 months.

Senator D'AMATO. In excess of 3 months?

Mr. GURIAN. Yes.

Senator D'AMATO. Now, at the end of that period of time, if he turns it down, are you given an opportunity to correct any of the deficiencies? Let's suppose he says, We think you are short *x* number of dollars in capital or equity. Your principal says, OK, I can come up with $50,000 more. Does that then take another 3 months, or is that a matter of weeks or days?

Mr. GURIAN. Well, it could take another couple of months.

Wayne Foren is sitting here in the room, who heads up, for all practical purposes, at the central office of the SBA, the 503 program.

Senator D'AMATO. Mr. who?

Mr. GURIAN. Wayne Foren.

Senator D'AMATO. Wayne, are you here?

Mr. FOREN. Yes, sir.

Senator D'AMATO. Say that last name.

Mr. FOREN. Foren, F-o-r-e-n.

Senator D'AMATO. Oh, come on up here. Don't hide back there. Give him a chair. You are lucky I have got to be out of here in a few minutes. [Laughter.]

This is wonderful. How are you, Wayne? Look, he is a nice-looking guy, too.

Mr. GURIAN. He is not only a nice-looking guy but he is a very capable guy, and he deserves a real amount of credit for the work that he is doing.

Senator D'AMATO. I can see you are a good politician. [Laughter.]

Mr. GURIAN. Oh, well, let's put it this way——

Senator D'AMATO. You made a fast kind of retreat there. I would have thought that this was some kind of devil by the way I heard this office was running.

Mr. GURIAN. Not at all. You know, the 502 program——

Senator D'AMATO. Wayne, let me ask you something.

Mr. GURIAN. Oh, I am sorry, Senator.

Senator D'AMATO. F-o-r——

Mr. FOREN. F-o-r-e-n.

Senator D'AMATO. Foren.

Mr. FOREN. Yes, sir.

Senator D'AMATO. Does 503 come under your jurisdiction?

Mr. FOREN. Yes, sir. I am the Director, Office of Lender Relations and Certification.

Senator D'AMATO. You hear all these things that all these different people, not only on Long Island but in Chicago and Kentucky, are saying. I guess it must be a nationwide problem. Let me ask you, what are your recommendations for speeding the process so that those loans that we all agree should be approved, those which are bona fide and qualified and meet the qualifications of the program, are acted on in a more expeditious manner? Give me the bottom line. What do you need?

Mr. **Foren**. The SOP that we have outstanding which has been referred to from time to time here today has a provision in it—I don't recall the specific number of days—but there is a provision in the SOP which requires the loan application to be acted on within a specific period of time.

In a broader sense, the district office is the delivery system for 503's, as in most of our programs. We have a traditional delivery system, from regional offices to district offices.

Of necessity, it is important that the district offices be the ones to make the credit decisions, and eligibility decisions. We have delegated that authority to them because they are familiar with the circumstances within their communities and have created, I believe, a good working relationship and rapport with most of the development companies.

The success or the failure of the program depends on, No. 1, the capability of the development companies, and then, No. 2, a close working relationship with our district offices.

Senator **D'Amato**. I am sure that a loan officer should be able to pick up the phone and call Gallagher and say, Look, I was just taking a look at this application. The bank is doing this, but what about that? Is that wrong?

Mr. **Foren**. No, there has to be that dynamics between the development companies and our field staffs around the country.

Senator **D'Amato**. I don't care about the country. I care about this one area. The SOP here says, "Oh, boy, if I could see better, too, I would really be deadly." Professor Bruce Ray says, "As a general rule, action should be taken on a 503 application within 15 working days of acceptance," and now we hear these people saying it takes months.

Mr. **Foren**. Well, Senator, I do not have the specific information. We will submit it for the record.

Senator **D'Amato**. Yes. What I would like you to do is to send to us a list of recommendations and tell me why you are not doing 15 days, why you are doing 6 weeks, 8 weeks, 3 months, because, obviously, we all understand that a delay of that time is fatal in many cases.

Mr. **Foren**. We agree with that. We will look into it and will send you our response.

Senator **D'Amato**. Let me ask you, what are some of the problems that you think we could deal with? I am not asking you to take on big policy changes. I mean, I want to tell you something, when I ran the town, if some builder was putting in for his building permit and some plan examiner was languishing around, I would get on his tail, because he used to take months, and find out why we were not getting it out. You either deny it or you approve it. Same thing here. Why?

Mr. **Foren**. When an application is submitted there are two items that we look at. One is eligibility and the other is credit.

From time to time, there are questions with respect to both, and these matters need to be resolved.

Senator D'AMATO. Would you say that the highest number of questions open deal with eligibility because these SOP's are changing so quickly?

Mr. FOREN. I would beg to differ with whoever made the observation that they change rather quickly. We change SOP's only in writing and it is a rather lengthy process. We do not change them every day, Senator.

Senator D'AMATO. All right. It would seem to me that the financial criteria would be pretty easy. You've got a loan officer and he is experienced. These CDC people are telling me, Look, we made 13 loans in all of Nassau and Suffolk Counties—there are 3 million people out there in a pretty urban area—we've got bank presidents and vice presidents on these boards, and they approved this application.

This comes to you. How long does it take to process?

Mr. FOREN. It certainly should not take 60 to 90 days or whatever. It should not take 3 to 9 months.

Senator D'AMATO. Who is in charge of that office?

Mr. FOREN. The District Director is in charge of the office. If it is a branch office, which is the case in Melville, we have a branch officer, and the branch office comes under the purview of the district.

Senator D'AMATO. Now, when he applies, he applies at 26 Federal Plaza in Manhattan, is that right?

Mr. GURIAN. Because there is only one officer in the whole district to handle the development corporation loans.

Senator D'AMATO. So now, he is not only handling yours, but there may be a State one, and there may be one in Chemung County, or here and there, et cetera, throughout the State.

Mr. GURIAN. That is correct, 17 counties.

Senator D'AMATO. Seventeen different CDC's, and you've got one guy handling them? One?

Mr. FOREN. The district offices, when necessary, will from time to time allocate their resources to address a workload problem. We do not, in the district office, mandate one 503 person to handle the 503 program; rather, we have a financing division within the district office that handles all loan applications.

Senator D'AMATO. All right. Wayne, you are going to do me a favor, right?

Mr. FOREN. Yes, sir.

Senator D'AMATO. You are going to find out why these things are taking an inordinate period of time, more than 15 days, in the New York office. If it is happening in the New York office, then it is happening in other offices. I have people from Kentucky and Chicago, and they have all said the same thing.

Mr. FOREN. We will look into it, sir.

Senator D'AMATO. But you must have had complaints about this before.

Mr. FOREN. Well, I have not had complaints of 9 months. I really have not.

Senator D'AMATO. No, wait a minute. Let's not use the worst-situation scenario, because what you will do is, you will come in and you will explain to me how come this guy had 9 months, what happened. I don't need that. I want to know why the average is obviously 6 or 8 weeks, why it is not down in the area of 30 days, even though you have 3 weeks. I understand 15 days; sometimes you have problems, you cannot do it, and you try; that I understand. But certainly 30 days.

Then can you also come up with some recommendations on how you are going to deal with the problem? These gentlemen seem to think this is one of the great problems, too. Inasmuch as we talk about IDB's, there is a higher authority, you know, Mr. Stockman, but when we talk about this situation, it is a little bit different.

I am glad we found you. [Laughter.]

Mr. FOREN. Well, I tried to hide back there in the back.

Senator D'AMATO. Yes, a big guy like you hiding? How come we didn't get him? [Laughter.]

Let me ask you something else. How long will it take you to give me a report on what we heard today and then some recommendations? If it is going to take a long time for the recommendations, why, you could just give me the report. How long will it take to analyze that?

Mr. FOREN. I would like to have some specificity, if I can use that word, with respect to what you would like included. For example, the NADCO recommendations——

Senator D'AMATO. As a general rule, action should be taken on 503 applications within 15 working days of acceptance. I want you to give me a report as to how many days does it take, how long are the time requirements on these 503 applications. If it is more than 15 days, and I would suspect it is considerably more, why? What is the bottleneck, and what is your recommendation to straighten this matter out?

Mr. FOREN. With respect to the processing time.

Senator D'AMATO. Yes. All right? Now, if you see any SOP recommendations—you heard these gentlemen talking about submitting them in June, I want you to comment on their—How many did you give me there? Where is Scott? How many?

Mr. BERMAN. Thirty-plus. There are about 34 recommendations.

Senator D'AMATO. They gave me 34 recommendations. I mean, if they have been talking to you and you are going to sit down and meet with them in 2 weeks, you are going to meet with them and it is going to be, "All right, we'll get back to you on that," you know, a lot of gobbledy-gook.

Let me ask you something. Will you please address to me, to this committee, Senator Weicker and this committee and everybody else, what is your response to these proposals?

Mr. FOREN. Yes, we certainly will do that. We have analyzed them. We have worked on some of them. Some of them we have already taken action on.

Senator D'AMATO. Really? Well, would you respond in writing to this committee?

Mr. FOREN. We will respond to the committee in writing within 2 weeks.

Senator D'AMATO. You will?

Mr. FOREN. Yes.

Senator D'AMATO. That is terrific! I cannot ask for more than that. And you are going to do that other thing, give me an analysis and a recommendation as to what we can do. That would be wonderful. Boy, we accomplished quite a bit without Dave Stockman today, too. [Laughter.]

[Subsequent information was received and follows:]

U.S. GOVERNMENT,
SMALL BUSINESS ADMINISTRATION,
Washington, D.C., October 15, 1982.

Hon. ALFONSE M. D'AMATO,
Chairman Subcommittee on Urban and Rural Economic Development, Committee on Small Business, U.S. Senate, Washington, D.C.

DEAR SENATOR D'AMATO: During the oversight hearing on the 503 Program which you held on September 28, concern was expressed about the time required to process 503 loan applications. You also expressed concern about the New York District Office. At that time, we agreed to look into the matter.

Our Internal Standard Operating Procedures generally require decisions within 15 working days from date of submission to SBA on 503 loan applications. Generally, we have found that when delays occur, they usually involve questions of eligibility, or credit, or the loan application is incomplete. To verify our preliminary findings, we have requested information from the field regarding processing time of loan applications submitted to SBA during the last six months of fiscal year 1982. Enclosed for your information is a copy of our internal memorandum to the Regional Administrators on this subject.

Regarding your concern about the New York District Office, Wayne Foren of my staff met with the New York Regional Administrator and the New York District Director. Certain technical issues involving eligibility were discussed and clarified. Also, a committment for additional resources as necessary was made. These actions should help overcome some of the concerns you expressed.

You also requested that we supply you with a copy of our response to the NADCO recommendations. Enclosed please find a copy of our response to those recommendations.

We appreciate you interest in the 503 Program and will furnish you a copy of the results of the survey on loan processing time, together with our analysis, when completed.

Sincerely,

EDWIN T. HOLLOWAY,
Associate Administrator for Finance and Investment.

Enclosure.

U.S. GOVERNMENT
SMALL BUSINESS ADMINISTRATION
WASHINGTON, D.C. 20416

OCT 15 1982

Honorable Alfonse M. D'Amato
Chairman
Subcommittee on Urban and Rural Economic Development
Committee on Small Business
United States Senate
Washington, D. C. 20510

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Sincerely,

(signed) Edwin T. Holloway

Edwin T. Holloway
Associate Administrator
for Finance and Investment

SBA

U.S. Small Business Administration
Washington, DC 20416

Memorandum

Date: OCT 6 1982

From: Deputy Associate Administrator for Financial Assistance

Subject: Processing Time for 503 Applications

To: All Regional Administrators

On September 28, oversight hearings were held on the 503 program in the Senate by the Subcommittee on Urban and Rural Economic Development. A concern expressed by the committee was the time being taken to process loans once they are received in the District Office.

It is noted that paragraph 32 of SOP 50-22 generally requires loans to be processed within 15 working days of acceptance.

So that we may be able to respond to the Committee, please provide the following information on each loan application submitted to SBA during the period April 1, 1982 through September 30, 1982. Consolidated regional reports should be submitted to Wayne Foren, Director, Office of Lender Relations and Certification by October 20. Negative reports must be filed for Districts that have no activity.

There should be a report per District Office. The report should provide the following information by Development Company:

1. Name of small business concern, amount of project and amount of debenture.
2. Date the project was received.
3. Date approved or denied.
4. Reason for action that took more than 15 days.

We regret having to ask for this information, but it is not available from the computer. We also believe that few offices will have to look at more than 10 files.

Your cooperation in this matter will be appreciated.

A copy of Mr. Sanders' testimony on the 503 program is being provided to you for your information (under separate cover).

Charles R. Hertzberg

Charles R. Hertzberg
Deputy Associate Administrator
for Financial Assistance

NADCO ISSUES

Alter-Ego

SBA's "alter ego" policy was first adopted because some small business owners form two legal entities for their business; one entity owns part or all of the fixed assets and the other entity is the operating company. Since the separation of the two entities represents legitimate, sound business practice the SBA allowed loans under this policy even though the business entity (one whose primary business is owning and operating real estate for investment purposes) would be benefited by the loan.

NADCO suggests a change be made to allow different ownership of two concerns and still permit them to qualify under the alter ego concept.

This suggestion included, as the reasons for this change, cases where a persons owns the real estate but owns the operating business in parternship with a son, or where the real estate is owned by the proprietor and a spouse but the operating business is solely owned. SBA has considered having something other than identical ownership of the two businesses but has rejected this approach. One reason for rejecting anything other than identical ownership of two entities is that there is little, if any, chance of any conflict of interest with identical ownership. Also, if the ownership had to be "substantially" the same, or the "majority" of the ownership must be identical, there is the problem of defining these two terms so that all offices will apply the same rule to the same circumstances. There is also the possibility that application of some definition of these terms will result in SBA loans being made to ineligible small businesses.

Although we will reconsider this matter modification or amendment of the current policy on alter ego is doubtful.

Adverse Change

As stated in the Standard Operating Procedural manual for the 503 program, SOP 50 22, "the Comptroller General has indicated that an interim lender's right to reimbursement from SBA depends upon the terms of the loan authorization." In accordance with the statutory requirement that assistance under 503 be made to an identifiable small business concern with a reasonable ability to repay its obligation to SBA, the following provision was developed for inclusion in the authorization.

> "Interim financing for total construction project cost is to be provided by (Lender) and prior to issuance of the debenture, CDC and SBA must be satisfied that construction has been completed in accordance with final plans and specifications, that no unpaid labor or material liens exist, that construction costs have not exceeded ($__________) project cost, that there exists a small business concern with the ability to repay its obligation to the CDC, and that such concern has not suffered a material adverse change since the date of this Authorization."

The program's statute requires that prior to SBA assisting a small business concern, such concern must have a reasonable assurance of being able to repay its financial obligations to SBA. As a result, this necessitates that SBA, not the first mortgage lender, determine prior to disbursement that no material adverse change has occurred in the financial condition of the small business which would prevent it from fulfilling its financial obligation. Such determinations by SBA are usually made as result of the following conditions.

1. Fraud or misrepresentation by the small business concern in the loan application and financial exhibits submitted to SBA.

2. Bankruptcy of the small business concern.

3. Assignment of the small business concern's assets for the benefit of its creditors.

4. Receivorship of the small business concern imposed by a third party creditor.

5. Forfeiture of the corporate charter of its corporation.

The policy of the 503 program is to provide assistance to healthy, expanding small business concerns that create or retain jobs, or otherwise have a meaningful economic impact in their community. For this reason, the likelihood of material adverse changes occuring in small businesses that receive 503 assistance should seldom if ever occur.

We hope this clarification will enable the Committee to understand the basis for SBA's policy on interim financing. We can assure you that SBA will continue to monitor and review this policy in order to make appropriate adjustments should it be warranted in the future.

Source of Interim Financing

SBA requires that all projects financed by a 503 debenture be fully completed in accordance with the terms and conditions of the authorization prior to the sale of the 503 debenture to the Federal Financing Bank. The CDC uses the authorization issued by SBA to secure interim financing to fund SBA's share of the project during construction. Following completion of the project, the 503 debenture is sold to the FFB for the purpose of taking out SBA's share of the project financing advanced by the interim lender.

Current SBA policy requires that the source of interim financing be provided by a regulated lending institution to ensure that the project is being properly monitored during the construction phase.

We intend to examine other methods of project monitoring. We feel it is essential that the interests of the Agency and the SBC are protected during the construction period.

Interim Financing on Machinery and Equipment

We intend to examine the recommendation by NADCO requesting a modification of SBA policy to permit sale of 503 debentures when project construction is complete and the project is awaiting the delivery and installation of machinery and equipment. We recognize in some instances the delivery of machinery and equipment may be delayed by unforeseen circumstances which result in increased costs to the small business concern. Although most contacts with our field offices do not indicate a large number of projects affected by this situation, SBA believes it warrants a thorough examination.

Ten Year Machinery and Equipment Debenture

The 503 program is intended to assist projects that have a significant impact on their community. We believe the 15, 20 and 25 year terms provided on 503 debentures are sufficient to assist such projects. We believe such projects can readily be assisted within our 7(a) program; however, we intend to study the recommendations for 10 year debentures.

Private Lender Definition and Restriction

Current SBA policy permits both regulated and non-regulated lenders to provide the non-federal share of 503 projects. For the first time in the development company (502 and 503), sources other than regulated lending institutions are permitted to participate with SBA in financing small business concerns. Since this is a new policy, we intend to review our portfolio of loans with non-regulated lenders to determine the status of such loans. Following such an examination, we would consider appropriate modification if the performance of such loans is consistent with loans financed by regulated lending institutions.

Taxable Earnings on the Reserve and Escrow Accounts

In an opinion rendered by the Internal Revenue Service, IRS has concluded that the interest which is credited to a small business concern's reserve and escrow accounts is includable in the small business concern's gross income for the taxable years in which the interest is so credited. This conclusion is equally applicable to both cash and accrual basis taxpayers. Annually, the Central Fiscal Agent (CFA) will provide the CDCs with the appropriate information on the taxable income for each small business concern in their portfolio.

Pursuant to SOP 50 22, paragraph 51(e), the SBA policy on the reserve and escrow accounts states that the total amount of funds in such accounts shall be maintained for the benefit of the small business concern by the CFA until the debenture has been satisfied. However, at such time as the total amount of funds in such accounts is equivalent to the outstanding debenture balance (the CFA shall provide the appropriate notification), the small business concern shall have the right to utilize the funds should they decide to prepay the debenture. Any decision to prepay prior to equality between the reserve and escrow accounts and the outstanding debenture balance shall be done so without the application of the funds in the accounts. Following prepayment by the small business concern, the CFA will remit all funds in the accounts to the small business concern.

The IRS opinion on the reserve and escrow accounts is being currently analyzed by SBA to determine its ramification on the investment functions performed for the benefit of the small business concerns. We intend to examine the cumulative impact on the small business concern as a result of the investment function performed by the CFA, the IRS opinion, and the SBA policy on reserve and escrow accounts.

Clarification of "In Anticipation Of"

SOP 50 22 paragraph 26f(3) permits:

Repayment of bonafide, short-term interim financing when the proceeds of such interim financing were actually used for plant construction, conversion and the like and had SBA approval in writing. SBA shall be permitted to take out short term interim finacing, provided the loan application is approved, if such financing had been in place no more than 180 days from the date the CDC receives written approval from SBA.

The policy stated above permits SBA the flexibility to take out "short-term" interim financing provided such financing has not been in place more than 180 days from the date SBA provides the CDC with written notification that it will take out the financing if the loan application is approved by SBA. We intend to study the language proposed by NADCO to determine if their recommendation would clarify the policy established by SBA.

Limitation on Refinancing Provisions

SBA permits debt consolidation provided that the amount used for such purpose is no more than 10% of the debenture proceeds. This policy is intended to apply to situations such as paying off a mortgage on real estate acquired prior to, or during early CDC involvement if, in such instances, clear title is essential to gain a first lien position on the real estate to establish the financial feasibility of the project. We shall study the recommendation by NADCO, however, we believe our current policy is consistent with the intent of the program's statute.

Leaseable Space in New Construction

Chapter 6, paragraph 26(d) of SOP 50 22 permits the following:

Debenture proceeds may be used for the construction of commercial rental space only under the following conditions: Commercial rental space, up to 15 percent of the total space is permitted when (a) reasonable projections of growth indicate the SBC will need additional space in the reasonably near future and (b) due to the nature of construction, it is not feasible to build an addition to the building in the future. The SBC must document in writing, and the CDC must certify, that the business receiving the 503 assistance will expand into the rental space within three years after completion of the building.

The policy identified above recognizes the need for expansion space by SBCs. However, since the statute requires 503 proceeds to be used for a sound business purpose, we believe a large percent of rented space would be used primarily for investment purposes and would violate the program's statutory intent. We intend to examine the issue further to determine if SBCs applying for 503 assistance are in need of more than 15% expansion space in new construction.

Attorney Fees

The policy set forth in the note to paragraph 36(a)(4)(b) of SOP 50 22 states that the legal fees of the CDCs counsel in closing a loan shall be considered part of the project cost and shall be funded out of the debenture proceeds. Such legal fees are not required to be covered by the CDC's 1.5% processing fees. We shall make the appropriate modifications to the regulations to reflect this policy.

502 Fees

NADCO recommends that the 502 program be provided the same fee structure as the one established by SBA for the 503 program. We shall examine this recommendation to determine its feasibility.

Upfront Deposit Fees

CDCs are entitled to two fees: a processing fee equal to 1 1/2% of the debenture guaranteed by SBA and a monthly servicing of 1/2% on the total outstanding balance of the debenture. Based on our analysis of a CDCs administrative and operating costs, we believe this fee structure should help defer most of the fixed expenses of active CDCs. We are now in the process of examining the time constraints involved in the 503 program to determine if the examples set forth by NADCO are adversely affecting a CDCs ability to operate. Our analysis will weigh the operating expenses of a CDC and the potential for abuses if the fee structure is adjusted.

Geographic Areas

SBA policy does not require a minimum area of operation for CDCs applying for certification. In some instances, an applicant may be encouraged to adopt a broader area of operations to ensure a reasonable level of activity.

Membership Requirements

Part 108.503-1(e) of SBA's regulations requires that a CDCs membership have representation from a government, a lending institution, a community organization and a business organization. The regulations require a minimum of 25 members, and that the CDC be representative of its area of operation. CDCs that operate on a statewide basis must have representation from the economic development agency of the state government. CDCs that operate countywide or are multi-county must have representation that ensures that each county is represented. Regional Planning Commissions or other similar organizations that represent subdivisions of a state would comply with the governmental representation requirement. The membership of a CDC must comply with the program's regulatory requirement and must ensure adequate representation throughout its area of operation.

Private Sector Leadership

It is the policy of SBA to encourage maximum participation in CDCs from the leadership of both the public and private sector. A recent amendment to Part 108.503-1(c) requires that a CDC's board of directors contain representation from a private sector lending institution.

Election of the Board

SBA intends to require that a CDCs board of directors be elected rather than appointed by its membership. A primary role of members in any corporation is to utilize their vote to elect board members. Without such a right, the members would have little control in the decision or directions taken by a CDC's board of directors.

Capitalization

SBA does not intend to require a CDC to provide a minimum level of capitalization for participation in the 503 program.

Single Purpose Building

SBA intends to clarify the Agency policy with regard to single purpose building.

Motels and Office Condos

The intent of SBA is to utilize the 503 program in a manner that will maximize its impact on labor intensive projects while also providing the flexibility to assist projects that have a significant impact on a community through the delivery of an important service or product. In this regard, the 503 program has a specific focus yet retains the flexibility to adopt to the needs of a particular community. It is the opinion of SBA that the 503 program was not intended to subsidize or finance the development of office condominimums where there is little or no community impact. For this reason, SBA policy restricts the use of 503 funds where demonstrated community or job impact cannot be adequately justified.

Turn Down Letters

Concerning the availability of other financing, SBA's policy as set forth in paragraph 19 of SOP 50 22 is as follows:

Application for financial assistance will not be accepted for processing and no assistance may be extended unless the CDC can demonstrate to the satisfaction of SBA that the desired financing is not available from non-federal sources on reasonable terms. Such evidence shall include a written notification from the first mortgage lender and the small business concern's bank of account stating that such financing is not available to the small business concern at the interest rate and terms prevalent in that community.

As stated in NADCO's memorandum, we believe that policy as stated is sufficient. We will examine this issue to determine field compliance, and will issue a clarification if necessary.

Assumption of a 503 Loan

SBA intends to study the feasibility of permitting assumptions. Paragraph 20(c)(2) does permit assumptions for purchase money mortgages under certain conditions.

Change in Ownership of SBC

We believe the language on change of ownership contained in the authorization already implies the intent of the language suggested for inclusion by NADCO. Any modification to the existing clause is, in our opinion, not necessary.

Financing Both M&E and Real Estate Assets

SBA intends to follow the recommendation of NADCO and include a single paragraph permitting the use of the weighted average concept in projects including both machinery and equipment and real estate assets.

Equity Build-Up in a Building

SBA's policy on the required injection from a CDC is set forth in paragraph 22(a)(1)&(2). A CDC shall be required to inject into each project an amount equal to at least 10 percent of the funds necessary to complete a given project. The CDC's injection may come from a variety of sources, including the following:

The injection of cash and property at fair market value received in exchange for shares of stock issued by the CDC without conditions, or cash, and such property for which the CDC is indebted. Property contributed as the CDC's injection shall be added to the project to determine its total project cost. (Refer to paragraph 17(c) for a definition of project costs.) For example, if a CDC or an SBC is contributing land with a value of $150,000 to a project that requires $850,000 to construct a building and purchase machinery and equipment, the total project cost shall be the total financing required, plus the asset contributed, to complete the project, in this case $1,000,000. Property contributions may be considered as the CDC's injection only when it is applied to project that involve the construction of a new building. The guidelines contained in paragraph 26(a) should be followed to determine the value of the property being contributed particularly when the property has been owned by the CDC or SBC for a number of years and there has been an appreciation on the value of such property. In projects that involve an expansion to an existing building, the CDC's required injection may not come from equity in the existing land and building.

Money contributed to the CDC by state or local governments, banks or other financial institutions, or the small business concern (or such small business concern's owners, stockholders or affiliates) receiving assistance from the CDC. Contributions or loans to the CDC for inclusion in such company's participation in the cost of a given project may not be conditioned on the granting of voting rights, stock options, or any other type of financial interest in or control of the CDC by the small business concern being assisted.

SBA will review the policy identified above to determine whether any change is appropriate.

Personal Net Worth in 502 Project

NADCO recommends that SBA issue a clarification permitting the 503 personal net worth test to be applied to 502 projects. SBA intends to examine this recommendation and determine whether such an amendment would be consistent with the statutory intent of the 502 program.

10 Year Balloon Payments

SBA's policy on balloon payments is set forth in paragraph 20(a)(5) of SOP 50 22 and is as follows:

Balloon payments may be considered where circumstances warrant their use. Balloon payments must be justified in the loan report and clearly identified in the loan authorization. Balloon payments shall be permitted only if the participating regulated lending institution provides a minimum term of ten years on the balloon payment. For example, a balloon may be permitted if the lending institution amortizes the loan over 20 years, with the balloon payment due at the end of 10 years. Under no circumstances may a balloon payment be due in less than ten years. If the balloon payment is permitted, the Loan Officer must determine to his/her satisfaction that the balloon payment will not adversely affect the SBC's ability to satisfy its financial obligation to SBA.

Current SBA policy does permit the flexibility to use balloon payments if properly documented and justified. However, it is a judgement decision by SBA, based on the merit of the project, to determine that such a payment will not adversely affect the SBC. We will examine this issue but feel our current policy is proper.

Rate Restrictions

On June 23, 1982 paragraph 20(a)(4) of SOP 50 22 was amended to permit regulated lending institutions to establish their own rate of interest, provided it was legal and reasonable. This conforms with the recommendation set forth by NADCO.

Forward Commitment

SBA has ruled that forward commitment arrangements from lenders, secondary market representatives, or others, is ineligible. The forward commitment arrangement would work as follows: Lenders would issue forward commitments to builders/developers that they will provide permanent "take out" financing based upon an SBA guaranty. The commitment could be contingent on purchases being eligible SBCs.

The lenders would receive substantial fees for these commitments. The builders, in turn, use these commitments to obtain interim construction loans to complete their projects.

The forward commitment arrangement constitutes a violation of existing SBA regulations because of the fee [(13 CFR 122.20(c)(2)(vi)], and the conflict of interest issue that is raised when the commiting lender is involved in the project as well as in the resulting SBA loans [13 CFR 120.5(a)(1)].

While SBA has always considered the individual purchase of business facilities an eligible loan purpose, and continues to do so, SBA has never been a real estate mortgage lender as such. Although this situation has come about as a result of the current problems in the conventional mortgage field, it is clear that SBA, with its resource limitations and specific mission requirements, cannot serve as a substitute for this historically available financing source. SBA does not intend to change or modify this policy prohibiting forward commitments.

Purchase Money Servicing Requirements

Current SBA policy requires all sources of private sector financing to provide adequate servicing assistance to the SBCs receiving such financing. SBA will modify paragraph 20(a)(c)(7) of SOP 50 22 and state that if the 503 debenture is senior to the purchase money mortgage financing, the source of such financing will not be required to service the loan.

Prepayment Penalties

SBA intends to study the suggestions set forth by NADCO concerning options available to alleviate the effect of prepayment on small business concerns.

CDC Servicing Requirements

SBA is in the process of finalizing the CDCs servicing obligations. Such servicing requirements will set forth as proposed regulations in the Federal Register in the near future.

CDC Reporting Requirement

The operating report provides SBA with information concerning a CDCs activities during the course of a fiscal year. Regulatory compliance examinations are performed on a selective, limited basis. This information will not be made available to SBA on a regular, annual basis on all CDCs. We believe the operating report provides SBA with an opportunity to analyze, on a yearly basis, a CDC's level of operation and effectiveness.

Private Sector Advisory Group

SBA welcomes all comments and suggestions by various groups that participate with our programs. However, our Advisory Council is mandated by statute and provides SBA with excellent private sector advice and assistance. We do not think another group is warranted at this time.

Regulations in SOP's

We are in the process of making appropriate modifications to the regulations to ensure program conformity and accuracy.

Mike Aubey Suggestions - Maine Development Company

We have reviewed the suggestions put forth by Mr. Aubey and recognize a number of the recommendations have considerable merit. However, we feel it essential to make the necessary technical provisions in the 503 program prior to addressing in specific terms the more encompassing issues set forth by Mr. Aubey.

Generally, however, we believe the recommendations are constructive.

U.S. GOVERNMENT
SMALL BUSINESS ADMINISTRATION
WASHINGTON, D.C. 20416

NOV 17 1982

Honorable Alfonso M. D'Amato
Chairman
Subcommittee on Urban and Rural Economic Development
Committee on Small Business
United States Senate
Washington, D. C. 20510

Dear Senator D'Amato:

This is in reference to my letter of October 15 in which I agreed to provide the results of our survey of processing time of loan applications submitted to the Small Business Administration during a six month period ended September 30, 1982.

Our survey showed that 289 loans were processed during the period and the average processing time was 16 days. It also comfirmed our belief that delays in processing generally involved questions of eligibility or credit and usually required additional information to resolve these issues. Enclosed for your information is a summary of the results of our survey.

Concerning the cost of the 503 program, an analysis has been made and the cost for FY 1981 was $735,000. This includes both direct and indirect expenses and is limited to salary and expenses. The cost of the program for FY 1982 has not yet been determined.

We trust this information will be helpful. Should you need additional information, please let us know.

Sincerely,

Edwin T. Holloway
Associate Administrator
for Finance and Investment

Enclosure

Survey of Processing Time
for
503 Loan Applications Received During
4/1/82 - 9/30/82

Region	Average Days	Total Work Days	Number of Loans
I	10	340	34
II	27	135	5
III	19	150	8
IV	16	443	28
V	14	1350	98
VI	13	295	23
VII	17	568	33
VIII	18	109	6
IX	21	864	41
X	25	331	13
TOTAL	16	4585	289

Note:

1. Of the 289 loans submitted 248 were approved 23 were declined, and the remaining 18 were either screened out or withdrawn.

2. Generally, loans that were not processed within 15 days required additional information to resolve eligibility or credit problems.

Senator D'AMATO. Well, I want to thank all the witnesses. It is an important and serious matter, and a lot of these things, the matter with the mirror image and what not, I cannot just come down on your side. There is a judgment, and Don Gallagher knows that. They have got to be in a position to know. It is one thing to say you have a building and a hunk of property, and Mom and Pop on one side own it, and Junior owns the business, and why shouldn't it be? Well, you know, they are prudent business judgments, so we cannot agree on every one of those things, but certainly we should attempt to eliminate wherever we possibly can those impediments, particularly those that do not make sense, that are counterproductive to the process, and eliminate those impediments and attempt to create a situation and environment where we can maximize utilization of the program.

I have a kind of feeling that there may be some people, maybe not in SBA but in different areas, who do not want the program to works, regardless of the fact that it creates jobs and is beneficial to the economy of this Nation, because they are these doctrinaires, whatever it is, who say that only the strong will survive and let the weak go out of business. They say we should not do it. They are opposed to the 503 program in philosophy.

Well, they are not the legislators; they are not the Congress. If they want to be and they want to change that, then they should run and get elected and then vote that way. So I think that is the problem we have got to deal with. So I sympathize with you, but I want the facts on it.

I thank everyone for participating. We stand in recess.

[Whereupon, at 11:41 a.m., the subcommittee recessed, to reconvene at the call of the Chair.]

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